

SCERS GROWTH ASSET CATEGORY INVESTMENT POLICY STATEMENT

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A. GROWTH ASSET CATEGORY INVESTMENT OBJECTIVE

The Growth asset category seeks to achieve the following investment objectives:

- Attractive returns that tend to be generated during a high growth and low/moderate inflationary environment, and which tend to be correlated to equity and credit risk factors.
- A combination of capital appreciation, income, and cash flow generation.
- Moderate levels of diversification within the asset category.

Asset classes within the Growth asset category include:

- Public Equities, including Domestic and International Equities
- Private Equity
- Public Credit
- Private Credit
- Growth Absolute Return

Asset class target weights within the Growth asset category are as follows:

Asset Class	Target		
	Minimum	Allocation	Maximum
Domestic Equity	18.0%	20.0%	22.0%
International Equity	18.0%	20.0%	22.0%
Private Equity	7.0%	9.0%	11.0%
Public Credit	1.0%	2.0%	3.0%
Private Credit	2.0%	4.0%	6.0%
Growth Absolute Return	1.0%	3.0%	5.0%
<i>Growth Asset Category</i>		<i>58.0%</i>	

Public Equities:

The investment objective of the Public Equity portfolio is to enhance total fund performance by investing in a diversified portfolio of publicly traded domestic and international equity securities across investment styles and market capitalizations, and through the use of passive and active externally managed strategies. The Public Equity asset class will strive to earn net returns in excess of the domestic and international equity index benchmarks, primarily from the selection of investment managers. SCERS shall seek to maintain reasonable levels of aggregate risk, as measured through standard deviation and tracking error.

Private Equity:

The investment objective of the Private Equity portfolio is to enhance the total fund performance through investments in non-publicly traded securities. Private equity investments are illiquid and long-term in nature. To compensate for the illiquidity and the higher risks of the private equity market, the Private Equity portfolio is

expected to generate a rate of return that exceeds the return of publicly traded equities over the long-term. Along with earning this 'illiquidity premium', SCERS shall strive to achieve additional excess returns primarily from the selection of investment managers.

Public Credit:

The primary objective of the Public Credit portfolio is to enhance returns relative to SCERS' broader fixed income exposure, through investments in high yield, bank loans, structured credit, event-driven investments, or distressed loans (at varying points in the cycle). Compared to traditional fixed income strategies, such as U.S. Treasuries and core plus, Public Credit strategies focus on more idiosyncratic and niche credit investments by virtue of possessing greater credit expertise and investment flexibility. The strategy helps achieve the objectives of moderate income generation and a source of return enhancement, but can also have higher correlations to equities than traditional fixed income strategies, and can detract from diversification and liquidity objectives that are associated with traditional fixed income strategies. However, Public Credit's correlation to equities can be mitigated with capabilities to hedge credit and other exposures through a credit cycle.

Private Credit:

The investment objective of the Private Credit portfolio is to produce attractive risk-adjusted returns and generate current cash flow through non-exchange traded lending strategies. Private Credit investments are illiquid and longer-term in nature than exchange traded fixed income investments. To compensate for the illiquidity, the Private Credit portfolio is expected to generate a rate of return that exceeds the return of exchange traded bank loans over the long-term. Along with earning this 'illiquidity premium', SCERS shall strive to achieve additional excess returns primarily from the selection of investment managers.

Growth Absolute Return:

The investment objective of the Growth Absolute Return portfolio is to generate market like returns, but with lower levels of volatility. Growth absolute return strategies tend to be more equity and credit centric, with higher standard deviations, positive equity and credit beta, and higher correlations than diversifying absolute return strategies, which reside within the Diversifying asset category.

B. BENCHMARKS

The Growth asset category total performance is evaluated by applying the investment performance of the individual asset class benchmarks weighted by the strategic asset allocation targets weights. The Growth asset class benchmarks are as follows:

Public Equities:

- ❖ Performance of Public Equity portfolio, and the underlying asset classes and segments, will be evaluated and compared against the following benchmarks. The Public Equity portfolio, asset classes, and most of the underlying segments are expected to outperform their respective benchmarks over a period of greater than three years.

Asset Class	Benchmark	Performance Expectation	Time Period
Domestic Equity	Russell 3000 Index	Exceed the Russell 3000 Index by 1%, net of fees	Greater than 3 years
Domestic Equity Large Cap	Russell 1000 Index	Exceed the Russell 1000 Index by 1%, net of fees	Greater than 3 years
Large Cap Passive	Russell 1000 Index	Match the Russell 1000 Index	Greater than 3 years
Large Cap Active - Fundamental	Russell 1000 Index	Exceed the Russell 1000 Index by 1%, net of fees	Greater than 3 years
Large Cap Active - 130/30 Extension	Russell 1000 Index	Exceed the Russell 1000 Index by 1%, net of fees	Greater than 3 years
Large Cap Active - Systematic Multi-Factor	Russell 1000 Index	Exceed the Russell 1000 Index by 1%, net of fees	Greater than 3 years
Domestic Small Cap	Russell 2000 Index	Exceed the Russell 2000 Index by 1.5%, net of fees	Greater than 3 years
Small Cap Value	Russell 2000 Value Index	Exceed the Russell 2000 Value Index by 1.5%, net of fees	Greater than 3 years
Small Cap Growth	Russell 2000 Growth Index	Exceed the Russell 2000 Growth Index by 1.5%, net of fees	Greater than 3 years

Asset Class	Benchmark	Performance Expectation	Time Period
International Equity	MSCI ACWI ex-US Index	Exceed the MSCI ACWI ex-US Index by 1%, net of fees	Greater than 3 years
International Equity Developed Markets	MSCI EAFE Index	Exceed the MSCI EAFE Index by 1%, net of fees	Greater than 3 years
Developed Markets Large Cap Value	MSCI World ex-US Index	Exceed the MSCI World ex-US Index by 1%, net of fees	Greater than 3 years
Developed Markets Large Cap Growth	MSCI World ex-US Index	Exceed the MSCI World ex-US Index by 1%, net of fees	Greater than 3 years
International All Country World (ACWI) ex-US	MSCI ACWI ex-US Index	Exceed the MSCI ACWI ex-US Index by 1%, net of fees	Greater than 3 years
Developed Markets Small Cap Value	MSCI World ex-US Small Cap Index	Exceed the MSCI World ex-US Small Cap Index by 1.5%, net of fees	Greater than 3 years
Developed Markets Small Cap Growth	MSCI World ex-US Small Cap Index	Exceed the MSCI World ex-US Small Cap Index by 1.5%, net of fees	Greater than 3 years
International Equity Emerging Markets	MSCI Emerging Markets Index	Exceed the MSCI Emerging Markets Index by 1.5%, net of fees	Greater than 3 years
Emerging Markets All Cap	MSCI Emerging Markets Index	Exceed the MSCI Emerging Markets Index by 1.5%, net of fees	Greater than 3 years

Private Equity:

SCERS Private Equity Portfolio	Benchmark	Time Period
Policy Index Benchmark	Cambridge Associates LLC Global Private Equity & Venture Capital Pooled IRR	3 to 5 Years
Long-Term Objective	Russell 3000 Index + 3%	5 to 10 Years

- ❖ Over the medium-term (3-5 years), after the program is fully invested, performance of the Private Equity portfolio is expected to exceed the return of the Cambridge Associates LLC Global Private Equity & Venture Capital Pooled IRR for the respective vintage years. The Cambridge Associates LLC Global Private Equity & Venture Capital Pooled IRR will also serve as SCERS' Policy Index.
- ❖ Over the long-term (5-10 years), the objective of the Private Equity asset class is to exceed the Russell 3000 Index by 3%, net of fees and expenses.
- ❖ Individual partnerships will be compared to the appropriate Cambridge Associates Universe category, adjusted for vintage year.

Public Credit:

SCERS Public Credit Portfolio	
Policy Index Benchmark	50% BofA ML US High Yield Master II and 50% CS Leveraged Loan Index

- ❖ Performance of the Public Credit portfolio is expected to exceed a blended benchmark of 50% BofA ML US High Yield Master II and 50% CS Leveraged Loan Index.

Private Credit:

SCERS Private Credit Portfolio	
Policy Index Benchmark	Credit Suisse Leveraged Loan Index + 2%

- ❖ The Credit Suisse Leveraged Loan Index plus 2% will serve as SCERS' Policy Index for Private Credit. Over all measurement periods, including while the program is being invested and after the program is fully invested, performance of the Private Credit portfolio is expected to exceed the return of the Credit Suisse Leveraged Loan Index by 2%, net of fees and expenses.

Growth Absolute Return:

SCERS Growth Absolute Return Portfolio	Benchmark	Time Period
Policy Index Benchmark	HFRI FoF Composite Index + 1%, net of fees and expenses	3 to 5 Years
Long-Term Objective	90-day T-Bills + 5%, net of fees and expenses	> 5 Years

- ❖ Over the medium-term (3-5 years), performance of the Growth Absolute Return portfolio is expected to exceed the HFRI FoF Composite Index plus 1%, net of fees and expenses. The HFRI FoF Composite Index plus 1% will also serve as SCERS' Policy Index.
- ❖ Over the long-term (greater than 5 years), the objective of the Growth Absolute Return portfolio is to exceed the 90-day T-Bills plus 5%, net of fees and expenses.

C. INVESTMENT GUIDELINES

1. Investment Descriptions:

Public Equities:

Public Equity investments shall include equity securities purchased on listed U.S. stock exchanges, non-U.S. listed stock exchanges, over-the-counter (OTC) markets (including NASDAQ), and also includes equity securities of foreign companies traded on registered U.S. stock exchanges. Eligible investments shall include publicly-traded common stock and preferred stock. Eligible investments are also listed in the Investment Guidelines of the Investment Management Agreements (IMAs) of externally managed investment manager mandates.

Equity investments are managed through external investment manager strategies. The Equity asset class is broken out by the following style buckets:

- ❖ *Value Stocks:* Stocks that trade at a lower price relative to their fundamentals and are considered undervalued by investors. Common characteristics of value stocks include high dividend yield, low price-to-book ratio, and/or low price-to-equity ratio.
- ❖ *Growth Stocks:* Stocks whose revenues and earnings are expected to grow at an above-average rate relative to the broad equity market. Growth stocks typically pay smaller dividends, as a growth company would prefer to re-invest retained earnings back into the company.
- ❖ *Large Capitalization Stocks:* Stocks of companies with a market capitalization value generally in the range of companies within the Russell 1000 Index. Market capitalization is calculated by multiplying the number of a company's shares outstanding by its stock price per share.
- ❖ *Small Capitalization Stocks:* Stocks of companies with a market capitalization value generally in the range of companies within the Russell 2000 Index. Market capitalization is calculated by multiplying the number of a company's shares outstanding by its stock price per share.

Private Equity Investments:

Private equity investments primarily involve the purchase of unlisted, illiquid common and preferred equity, and to a lesser degree, subordinated and senior debt of companies that are typically privately held. Investment is authorized in vehicles and investment strategies that invest in a broad array of various securities, including but not limited to:

- ❖ *Buyout Investments* - Investments include acquisitions, growth equity, recovery investments, subordinated debt, and special situations (a

category which represents a diversified strategy across many sub-categories). Investments are made across the market capitalization spectrum and typically involve the purchase of a control position (primarily majority positions, with some minority positions) in an established company and may include the use of leverage in the form of debt. Investments are typically made in years one through six and returns typically occur in years three through ten. The potential for fund term extensions of up to three years is typically structured into most buyout funds. Investments may be made in companies that are either U.S. or non-U.S. domiciled.

- ❖ *Venture Capital Investments* - Investments include companies in a range of stages of development from start-up/seed-stage, early stage, and later/expansion stage. Investments are typically made in years one through six and returns typically occur in years four through ten. The potential for fund term extensions of up to three years is typically structured into most venture capital funds. Investments may be made in companies that are either U.S. or non-U.S. domiciled.
- ❖ *Distressed Debt Investments* - Investments include the debt instruments of companies which may be publicly traded or privately held that are financially distressed and are either in bankruptcy or potential candidates for bankruptcy. Typical holdings are senior and subordinated debt instruments. Equity exposure is acceptable as debt positions are often converted to equity during the bankruptcy reorganization process. Investments are typically made in years one through five and returns typically occur in years three through ten. The potential for fund term extensions of up to three years is typically structured into most distressed debt funds. Investments may be made in companies that are either U.S. or non-U.S. domiciled.
- ❖ *Other Investments* - Investments include strategies that do not fall in the above three categories or do not justify a separate long-term allocation.

Public Credit:

Public credit strategies focus on more idiosyncratic and niche credit investments by virtue of possessing greater credit expertise and investment flexibility. The strategy helps achieve the objectives of moderate income generation and a source of return enhancement, and the strategy's correlation to equities can be mitigated with capabilities to hedge credit exposures through a credit cycle. The strategy includes primarily high yield corporate bond and bank loans, but can also include high grade corporate bonds, derivatives, government bonds, distressed credit, defaulted securities, and cash.

Private Credit:

Private credit is an illiquid, lending-oriented strategy focused on private loans to performing companies. It includes primarily debt investments, where an investor expects to receive principal and interest, with the majority of returns being generated from cash flow yield. Private credit is typically structured with floating rate loans, with a spread over Libor, so cash flow income increases as interest rates increase, but can also include fixed rate loans. The average maturity of a loan is generally five years; however, loans tend to be repaid prior to maturity, so the average life of the loans is generally three years. Most loans are senior secured loans. Loans are typically either sponsored (private equity backed companies) or non-sponsored. Non-sponsored loan typically have higher yields than sponsored loans. Private Credit fund terms are typically 5 to 8 years, with investment periods between 2 and 3 years. The potential for fund term extensions of up to three years is typically structured into most Private Credit funds. Investment is authorized in vehicles and investment strategies that invest in two sub-strategies, including:

- ❖ *Direct Lending* - Direct lending investments are directly originated, non-traded, performing loans made to primarily middle market companies. Direct lending investments primarily are comprised of senior secured debt, which can be secured by general corporate collateral or by a company's specific collateral. Equity participation can be structured into the loan, typically through warrants, but this is generally a small component of the strategy. Direct lending investments often utilize leverage (typically in the range of 0.5 to 2.5 times) at the fund level. Direct lending investments also have broadly diversified sector exposure and include a combination of sponsored (private equity backed companies) and non-sponsored borrowers. The majority of investments will be made in companies that are U.S. domiciled, however, non-U.S. domiciled companies can also be included.
- ❖ *Opportunistic Credit* - Opportunistic credit investments are also performing loans like direct lending (not distressed), but represent a broader range of investment types. Opportunistic credit includes mostly senior secured structures, but can also include subordinated debt structures, convertible debt, and structured equity. Opportunistic credit is often designated as an asset-backed lending strategy, where collateral comes in the form of specific assets such as receivables, inventory, or royalty streams. Opportunistic credit investments can have meaningful equity participation, depending on the structure. This is often in the form of warrants and convertible bonds, but can also include direct equity participation. Opportunistic credit investments typically utilize little to no leverage. Opportunistic credit funds generally can have a targeted sector focus, which can often include only one sector, and generally are targeted toward non-sponsor borrowers. The majority of investments will be made in

companies that are U.S. domiciled, however, non-U.S. domiciled companies can also be included.

Growth Absolute Return:

SCERS' overall Absolute Return asset class has a target allocation of 10% and is broken out into two separate segments of SCERS' total portfolio. The Growth Absolute Return portfolio has a 3% target allocation and resides within the Growth asset category. The Diversifying Absolute Return portfolio has a 7% target allocation and resides within the Diversifying asset category. The distinction is to separate those strategies that typically do well during a more favorable economic environment and have higher correlations and betas to equity and credit markets, from those strategies that have low to negative correlation to equity markets and serve as a diversifier to the more growth oriented segments of SCERS' portfolio.

Growth absolute return strategies tend to be more equity centric, with higher standard deviations and positive equity beta and correlation, while the diversifying strategies within the Diversifying asset category tend to be diversifiers to SCERS' Growth asset category and overall portfolio, with lower standard deviations, and negative equity beta and correlation.

SCERS' alternative assets consultant breaks the absolute return universe into the following investment strategies. A well-diversified absolute return portfolio will contain allocations to each of these strategies at varying target weights.

- ❖ *Equity Long/Short* - Strategies where there is a combination of long and short positions primarily in publicly traded equities, with a net market exposure less than that of the overall equity market. Strategies may be focused on U.S., non-U.S., and/or specialty mandates.
- ❖ *Event Driven* - Strategies such as activist equity, risk arbitrage, merger arbitrage, distressed debt, credit, and other event-driven strategies.
- ❖ *Credit/Distressed* – Strategies that typically utilize fundamental credit analysis to invest in below investment grade, stressed, or distressed corporate and asset-backed credit. Managers may take long and short positions in mispriced debt instruments and may become actively involved in a restructuring process.
- ❖ *Market Neutral* - Strategies such as equity market neutral, fixed income arbitrage, and convertible bond arbitrage.
- ❖ *Global Macro* - Strategies such as all market portfolios, opportunistic long-only, managed futures, currency, dedicated short selling strategies, or other specialty strategies.

- ❖ *Multi-Strategy* - Strategies where absolute return funds invest using a combination of previously described strategies.

Examples of the more growth oriented and correlated absolute return strategies that typically reside within the Growth Absolute Return portfolio include equity long/short, event driven, and credit/distressed strategies, whereas the Diversifying segment will generally contain market neutral, global macro, and multi-strategy strategies. However, in practice SCERS will categorize individual strategies based upon each fund's expected characteristics, including risk, market sensitivity and market exposure, not by a fund's stated strategy, so each absolute return segment could include a variety of fund strategies.

2. Risk and Diversification:

Growth asset category investments, like investments in most asset categories, bear an inherent risk that the actual return of capital, gains, and income will vary significantly from expectations. The expected volatility of Growth asset category investments are often higher than in other parts of the SCERS portfolio. The investment risks associated with Growth asset category segments shall be addressed in several ways:

- ❖ ***Diversification by investment strategy and geography, including target allocation and ranges.***

The construction of the Growth asset category is important because a well-developed portfolio can add diversification to an asset category that is subject to higher levels of expected volatility. Distinguishing characteristics of the Growth asset category are: (1) a wide range of assets in both the public markets (liquid) and private markets (illiquid); (2) and a number of differing investment strategies across several underlying asset classes.

The targeted and range of investment exposures within the various asset classes are shown below. It is also anticipated that SCERS will seek diversification with respect to investment strategies within the asset classes where warranted.

Public Equities

Target allocations and ranges for the domestic equity and international equity asset classes are provided below:

Asset Class	Target Allocation	Target Allocation
Domestic Equity		
Domestic Equity Large Cap	90.0%	
Large Cap Passive		54.0%
Large Cap Active - Fundamental		12.0%
Large Cap Active - 130/30 Extension		12.0%
Large Cap Active - Systematic Multi-Factor		12.0%
Domestic Small Cap	10.0%	
Small Cap Value		5.0%
Small Cap Growth		5.0%

The Domestic Equity asset class contains a combination of passive and active mandates and is separated between the large capitalization and small capitalization segments. The large capitalization segment takes a core approach, without dedicated allocations to either the value or growth style bias. The small capitalization segment is allocated among the value and growth styles.

Asset Class	Target Allocation	Target Allocation
International Equity		
International Equity Developed Markets	80.0%	
Developed Markets Large Cap Value		25.0%
Developed Markets Large Cap Growth		25.0%
International All Country World (ACWI) ex-US		20.0%
Developed Markets Small Cap Value		5.0%
Developed Markets Small Cap Growth		5.0%
International Equity Emerging Markets	20.0%	
Emerging Markets All Cap		20.0%

The International Equity asset class contains 100% active mandates, without any passive allocations, and is separated between developed markets and emerging markets segments. The developed markets are further broken out between large capitalization and small capitalization segments, and contains a

combination of core, value, and growth styles. The emerging markets allocation is diversified across capitalization and styles.

Private Equity:

For the Private Equity asset class, the targeted and range of investment exposures to the various private equity investment categories and geographies are shown in the table below. These exposures should be measured on a fair value basis, once the Private Equity portfolio is fully invested. SCERS shall endeavor to limit the potential for any concentration in a type of investment strategy or geography to negatively impact long-term returns in the Private Equity asset class by adhering to these targets and ranges. It is expected that the non-U.S. investments will be further diversified across different regions.

SCERS Private Equity Portfolio Construction			
	Minimum	Target	Maximum
Total Private Equity Portfolio	7%	9%	11%
U.S Focused			
Buyout	30%	50%	70%
Distressed Debt	0%	10%	20%
Venture Capital	10%	20%	30%
Other	0%	0%	15%
Non-U.S Focused			
Buyout	10%	15%	20%
Distressed Debt	0%	2%	10%
Venture Capital	0%	3%	10%
Other	0%	0%	5%

SCERS will favor a concentrated approach by allocating approximately 3%-6% of the total Private Equity target allocation to each fund. SCERS will strive to maintain ongoing long-term relationships with approximately 25 private equity managers with an expected range of 20-30 manager relationships. No single investment manager will exceed 10% of SCERS’ total active commitment level, unless the vehicle is a fund of funds or separate account advisory relationship. The optimum number of investment vehicles in the portfolio and the maximum exposure to any one investment vehicle varies with time and will be evaluated as part of the Private Equity Asset Allocation Structure.

Public Credit:

Public Credit is given a 2% target allocation, with a flexible mandate that primarily invests across high yield bonds and bank loans, but can also invest within structured credit, event-driven investments, or distressed credit (at varying points in the cycle). The strategy also uses macro hedges to protect capital during a down market.

Private Credit:

The targeted and range of investment exposures to the identified Private Credit investment sub-strategies and geographies are shown in the table below.

These exposures should be measured on a fair value basis, once the Private Credit portfolio is fully invested. The primary geographic focus within the Private Credit portfolio will be in the United States, though the portfolio can also include non-U.S. investments to increase geographical diversification. It is expected that the non-U.S. investments will be further diversified across different regions.

SCERS Private Credit Portfolio Construction			
	Minimum	Target	Maximum
Total Private Credit Portfolio	2%	4%	6%
Direct Lending	50%	70%	100%
Opportunistic Credit	0%	30%	50%
U.S. Private Credit	75%	85%	100%
Non-U.S. Private Credit	0%	15%	25%

SCERS will favor a concentrated approach, particularly within the direct lending segment, by allocating approximately 15%-25% of the total Private Credit target allocation to each fund. SCERS will strive to maintain ongoing long-term relationships with approximately 10 private credit managers with an expected range of 8-12 manager relationships. The optimum number of investment vehicles in the portfolio and the maximum exposure to any one investment vehicle varies with time and will be evaluated as part of the Private Credit Asset Allocation Structure.

Growth Absolute Return:

Absolute return funds represent a distinctive investment style that is different from traditional, long-only funds. A fundamental difference is that absolute return fund managers emphasize absolute, rather than relative returns, and they may also use a wider range of investment techniques, such as leverage, short selling, and derivatives to achieve their objectives. This greater level of investing flexibility results in a wide range of strategies that produce different risk and return characteristics between the strategies and provides the opportunity to diversify risk.

SCERS shall strive to invest in a sufficient number of managers and set constraints on the size of each absolute return manager compared to the Absolute Return portfolio and the total portfolio. This will provide some protection and spread the unique risks of absolute return funds across a larger base. These risks include operational risk, headline risk, event risk, liquidity risk, counterparty risk, leverage risk, and reduced transparency.

Accordingly, investing in a large number of funds across the aggregate SCERS Absolute Return portfolio, and within the Growth Absolute Return segment, combined with investing across a range of strategies, can assist in achieving

the Growth Absolute Return portfolio's objective of generating market like returns, but with lower levels of volatility.

For the Growth Absolute Return portfolio, the target number and range of funds, and targeted geographic ranges are shown in the table below. In addition, the primary targeted absolute return strategies for the Growth Absolute Return portfolio are shown. In practice, SCERS will categorize individual strategies based upon a fund's expected characteristics, including risk, market sensitivity and market exposure, not by a fund's stated strategy, so the Growth Absolute Return portfolio can also include a wider variety of fund strategies.

	Growth Absolute Return
Portfolio Objective	Equity and credit like returns over the long-term with lower volatility than equities and credit markets
Target Allocation	3% of total assets
Allocation Range	1% to 5% of total assets
	Credit/Distressed
Primary Strategies	Event Driven
	Equity Long/Short
Number of Funds	Target 5 funds with a range of 2 to 8 funds
Non-U.S. Exposure	Expect 20% to 40% non-U.S. exposure

Within these guidelines, and in light of ever-changing market conditions, Staff and consultant will allocate funds within each investment style in a manner that, in their judgment, enhances SCERS' ability to achieve the investment objectives of the Growth Absolute Return portfolio over the long term. In the event exposure to an absolute return style becomes overly concentrated, Staff is authorized to rebalance assets in a manner consistent with the implementation protocol within this Growth Investment Policy Statement.

❖ *Diversification by selection of individual funds:* SCERS will strive to select individual growth absolute return funds based on their ability to enhance returns and provide diversification for SCERS' total fund. The growth absolute return funds would be expected to demonstrate the following characteristics relative to the other investments held in the Growth asset category:

- Lower correlation to equities.
- Less correlated alpha sources.
- Lower beta compared to equities.
- Lower kurtosis in the return distribution (smaller extreme returns both positive and negative).
- Positive skew in the return distribution (larger and more frequent occurrences of positive returns versus negative).

- Ability to exhibit less downside in declining equity markets.
 - Capability to partially manage tail risk.
- ❖ *Diversification across geographies, business sectors, and asset classes:* It is expected that absolute return managers will be actively, and oftentimes quickly, changing the composition of portfolios to take advantage of opportunities in the markets. Accordingly, it will be important to actively monitor and understand the dynamic absolute return environment relative to more general objectives, making portfolio changes when necessary rather than reacting to rigid guidelines. This should allow SCERS to capture the benefits of allowing absolute return managers to execute their strategies without compromising the objectives of SCERS' aggregate fund or total portfolio. These general objectives include:
- Geographic diversification in non-U.S. regions.
 - Diversification across sectors and industries.
 - Diversification across asset classes.
- ❖ *Minimum size of absolute return managers:* Requirements for absolute return funds to register with the SEC and provide greater shareholder transparency and reporting have increased, along with operating costs, benefitting larger funds with the in-house capabilities to manage these issues. However, small and mid-sized funds can often perform better, particularly during the phase when the absolute return partners are more focused on generating returns to build initial wealth. To balance these considerations, SCERS will invest in absolute return funds with minimum assets under management greater than \$250 million.

3. Asset Class Specific Risk Considerations:

Public Equity:

With public equity investments, there is an inherent risk that the actual returns will vary significantly from expected returns. Publicly traded equities generate significant levels of volatility (measured by standard deviation), and emerging markets tends to exhibit higher volatility than developed markets. Public equity investments also expose investors to high levels of equity market beta and the equity risk premium (ERP). Investment returns and risks within SCERS' Public Equity portfolio shall be measured according to all or some of the following measures:

- *Standard Deviation:* A measure of volatility which calculates the dispersion of returns from an average rate of return.
- *Sharpe Ratio:* A ratio that measures risk-adjusted performance. In particular, it measures a portfolio's excess returns over the risk free rate, and divides the result by the standard deviation of the portfolio returns.

- *Tracking Error:* The standard deviation, or volatility, of excess returns generated between a portfolio and that of a benchmark.
- *Information Ratio:* A risk-adjusted performance measure which calculates a portfolio's excess returns above a benchmark, and divides the result by the tracking error, or volatility of the excess returns.
- *Beta:* A measure of the sensitivity of a security or portfolio in comparison to the market as a whole. Beta measures the tendency of a security's or a portfolio's return to swings in the market.

The investment risks associated with the Public Equity portfolio shall be addressed in several ways:

- *Diversification by geography:* SCERS shall maintain a Public Equity portfolio that is diversified across geographies. Public equities shall encapsulate the domestic equity markets and the international equity markets, including both developed and emerging markets. SCERS' Public Equity portfolio comprises 41% of SCERS total portfolio and is split 21% and 20% between domestic and international equities, respectively.
- *Diversification across style:* SCERS' Public Equity portfolio shall seek to maintain style neutrality across the Domestic Equity and International Equity asset classes, and the various sub-asset classes. This includes an approximate equal weight across both the value and growth styles, and/or to core strategies that will inherently be style neutral across a market cycle.
- *Diversification across market capitalization:* SCERS' Public Equity portfolio invests across the large-capitalization and small-capitalization spaces. While the portfolio does not consist of any dedicated mid-capitalization mandates, exposure to mid-cap stocks is provided by SCERS' large and small capitalization strategies
- *Diversification across externally managed active investment mandates and passive investment mandates:* A key variable in the decision to use active mandates over passive mandates is the probability of active equity managers generating consistent excess returns over the benchmark in aggregate. The ability to generate excess returns depends on the region, market capitalization, and style that an investor has exposure to. Within domestic equities, domestic small cap has historically produced a higher probability of excess returns versus domestic large cap. International developed and emerging market equities have historically produced a higher probability of excess returns.

- *Diversification by investment manager:* SCERS' Public Equity portfolio will seek to allocate capital to a variety of external investment managers in order to ensure diversification by asset class, sub-asset class, style and region, and to avoid concentration of capital to any specific manager or factor exposure. However, SCERS will seek to avoid manager redundancies through over-diversification to external investment managers. This will be accomplished by keeping track of portfolio characteristics and exposure levels of investment managers, including unnecessary overlap of individual security positions among managers.
- *Diversification by sector and industry:* SCERS' Public Equity portfolio shall achieve diversification across sectors and industries among its equity investment managers, and across the aggregate Domestic and International Equity portfolios. Individual investment manager guidelines shall call for the prudent allocation of assets across sectors and industries, to avoid over-concentration to any sector or industry.

Growth Absolute Return:

There are several risk considerations specific to the Growth Absolute Return portfolio:

	Growth Absolute Return
Portfolio Objective	Equity and credit like returns over the long-term with lower volatility than equities and credit markets
Risk Target	Standard Deviation < 50% of global equities
Market Sensitivity	Target an equity beta <0.5 Target equity correlation <0.8
Market Exposure	Total notional gross exposure < 250%

- *Absolute Return Risk Targets:* Absolute return portfolio risk is often measured by standard deviation. The target standard deviation for Growth Absolute Return is less than 50% of the MSCI ACWI Index.
- *Market Sensitivity:* Common measures for market sensitivity for an absolute return portfolio are beta and correlation. The equity beta target for the Growth Absolute Return portfolio is <0.5, and the equity correlation target is <0.8.
- *Market Exposure/Leverage:* Within absolute return, leverage may be utilized by underlying absolute return managers as part of their strategies, but it will not be employed at the total portfolio level.

Leverage at the total Growth Absolute Return portfolio level is the aggregated amount from SCERS' underlying managers and will be defined as the total notional gross exposure, which is equal to the sum of gross long notional exposure plus gross short notional exposure, expressed as a percentage of total invested capital. Total leverage for the Growth Absolute Return portfolio will not exceed 250%.

In addition, leverage utilization will be monitored within each individual hedge fund and investment manager to ensure appropriateness given the respective strategy.

Private Investments:

Private investments, (e.g. private equity and private credit), like investments in most asset classes, bear an inherent risk that the actual return of capital, gains, and income will vary significantly from the return and amounts expected. The expected volatility of private investments in aggregate is high among major asset classes. The investment risk associated with private investments shall be addressed in several ways:

- *Diversification by geography and investment strategy.* SCERS will endeavor to limit the potential for any concentration in a type of investment strategy or geography to negatively impact long-term returns in the Growth asset category by investing across regions and strategies.
- *Diversification by vintage year.* SCERS will strive to limit the potential for investments during any given year in the business cycle to negatively impact the long-term results of the Growth asset category by investing across business cycles and vintage years. It is anticipated that SCERS will commit to private market funds (i.e., private equity and private credit) over multiple years, whereby the aggregate amount will be spread across the entire business cycle. This will serve to limit the exposure or risk to investing and relying on the performance of private funds in any given year of the business cycle. The Board will determine with SCERS' investment staff and consultant the funding allocation for the private segments of the Growth asset category each year in conjunction with its annual review of the Asset Allocation Structure and Annual Investment Plan for asset classes such as Private Equity and Private Credit.
- *Diversification by industry or business sector.* SCERS will attempt to limit the potential for any one industry or business sector to negatively impact the long-term results by investing across a variety of industries.
- *Diversification by investment manager and general partner.* SCERS will endeavor to invest across a number of investment managers and limited partnerships to mitigate the potential negative impact of a concentrated portfolio of investment managers. The optimum number of investment

vehicles in the portfolio and the maximum exposure to any one investment vehicle will vary with time and will be evaluated as part of the Growth asset allocation structure.

4. **Investment Vehicles:** The vehicles for investments within the Growth asset category reflect the broad scope of investments held within this asset category.

Public Equities and Public Credit:

Investment vehicle options for investing in the Public Equity and Public Credit asset classes include separate accounts, in which assets are custodied at SCERS' custodian, and/or commingled funds, including limited partnerships and institutionally investor-focused mutual funds. Determinants as to whether SCERS will invest in a separate account versus a commingled fund include availability of a separate account option, complexity of the underlying assets, whether individual country markets require opening (i.e., emerging markets investing via a separate account), fee levels, transparency, and whether a commingled fund's investment guidelines are consistent with SCERS' investment objective.

Private Equity:

Investment vehicles for private equity investments are often commingled funds, structured as private limited partnerships, but may also include other entities such as limited liability companies or offshore corporations. Private equity limited partnerships are drawdown structures with management fees and carried interest. It is anticipated that the majority of SCERS' Private Equity investments will be made through direct investments into private equity limited partnerships.

SCERS may also invest directly in fund-of-funds (FoF) vehicles. In these vehicles, the FoF invests in private equity partnerships on a discretionary basis. FoFs will own the underlying private equity partnerships and SCERS obtains contractual rights to the FoFs' portfolio through a limited partnership. A FoF will have investors other than SCERS.

SCERS may also invest in separate account relationships established with one or more fiduciary oversight managers. These managers will make commitments to private equity limited partnerships, or other entities such as limited liability companies or offshore corporations, either on a discretionary or advisory basis.

Private Credit:

A common investment vehicle for private credit investments is a commingled fund, structured as a limited partnership. Private credit limited partnerships are drawdown structures with management fees and, and typically carried interest. Direct lending strategies generally have lower fees and carried interest than

other private market strategies, and often only charge management fees on invested capital, not committed capital. Opportunistic funds can have higher management fees and carried interest given their higher return targets.

Separate accounts are also a vehicle that can be used to invest in private credit. Separate accounts are larger and customizable accounts with investment managers that have greater flexibility in the guidelines, greater input from Staff and consultant, and may have lower fees. Separate accounts generally have a size of \$100 million or greater.

Another investment vehicle that is common in private credit is private business development companies (BDCs). Private BDCs have similar investment strategies as a private commingled fund but have a differing structure. These vehicles can have lower fees, lower yields, and the potential to earn a return premium by going public through the IPO markets.

SCERS may also invest directly in fund-of-funds (FoF) vehicles. In these vehicles, the FoF invests in private credit partnerships on a discretionary basis. FoFs will own the underlying private credit partnerships and SCERS obtains contractual rights to the FoFs' portfolio through a limited partnership. A FoF will have investors other than SCERS.

Growth Absolute Return:

Investment vehicles for absolute return investments are typically separate accounts and/or a variety of commingled vehicles, such as limited partnerships, limited liability companies, or offshore corporations.

SCERS may also invest directly in fund-of-funds (FoF) vehicles. In these vehicles, the FoF invests in absolute return partnerships on a discretionary basis. FoFs will own the underlying absolute return partnerships and SCERS obtains contractual rights to the FoFs' portfolio through a limited partnership. A FoF will have investors other than SCERS.

SCERS may also invest in separate account relationships established with one or more fiduciary oversight managers. These managers will make commitments to absolute return limited partnerships, or other entities such as limited liability companies or offshore corporations, either on a discretionary or advisory basis.

- 5. Secondary Investments and Co-investments:** Secondary investments are made when an investor purchases the limited partnership interest of another investor in an existing fund. A co-investment is a direct investment in an underlying portfolio company where a manager offers investors the opportunity to invest directly in an underlying company alongside the fund investment. Investments may be made in companies that are either U.S. or non-U.S. domiciled. Neither secondary investments nor co-

investments are considered separate investment strategies within the Growth Asset Category. For example, a secondary or co-investment could be in any of the strategies and will be most prevalent within the Private Equity and Private Credit asset classes, but also within the Growth Absolute Return portfolio. Therefore, secondary and co-investments will be categorized according to the underlying strategy and geography and will conform to the guidelines outlined in the above section on risk and diversification. SCERS will seek to allocate to secondary investments and co-investments on an opportunistic basis. It is expected that these investments will constitute a small portion of the overall Growth asset category, and any underlying asset class, if any.

6. Investment Vehicle Concentration:

Public Equity and Public Credit:

SCERS shall typically not comprise more than 20% of an investment strategy's assets under management at the initiation of the investment. Post-investment, SCERS shall monitor the investment strategy asset base, and SCERS' concentration relative to the asset base. An exception to this guideline is an investment in a separate account, whereby SCERS may be the sole investor. In these circumstances, SCERS will endeavor to ensure that it does not generate a majority of the firm's overall profits.

Private Equity, Private Credit, and Growth Absolute Return:

SCERS shall not comprise more than 20% of any one investment vehicle at the initiation of the investment that is a limited partnership, limited liability company, or offshore corporation. The exception to this guideline is an investment in a FoF or a separate account, whereby SCERS may be the sole investor. In these circumstances, SCERS will make reasonable efforts to ensure that it does not generate a majority of the firm's profits.

7. Liquidity: Overall, the Growth asset category will maintain varying levels of liquidity based on the underlying sub-asset classes:

Public Equity and Public Credit:

Investments in public equity and public credit markets offer varying degrees of liquidity depending on region, market capitalization for equities, and bond sector; however, liquidity is generally high relative to other asset classes. In public equities, larger capitalization stocks generally have higher average daily volumes and a greater number of trading intermediaries, and therefore offer higher liquidity levels than smaller capitalization stocks.

Among investment vehicles, investing through separate accounts typically offer the highest liquidity, as the underlying assets are owned by SCERS, and are held at SCERS' custodian. While the underlying assets of commingled funds offer high liquidity, there is the potential for less immediate liquidity when

redeeming assets from a commingled fund. This liquidity can vary from immediate to monthly liquidity, depending on the structure of the fund.

Private Equity and Private Credit:

Private equity investments are illiquid and typically have long expected holding periods such as 10-13 years. Investments are typically held until maturity and selling prior to maturity may result in realizing a sales price that reflects a discount to fair market value.

Private credit investments are illiquid and typically have longer expected holding periods such as 5-8 years. While the majority of investments are tied to coupon payments and cash distributions are returned to investors on a quarterly basis, most investments are held until maturity or full repayment and selling an interest in a fund prior to maturity may result in realizing a sales price that reflects a discount to fair market value.

Liquidity risk is managed by minimizing the possibility of forced sales that may arise from exceeding maximum exposure limits, or lowering asset allocation targets to private equity or private credit investments. In order to better assess liquidity needs, a capital budget and cash flow forecast will be developed over a ten year horizon and updated as necessary. The assumptions of this forecast are stress tested in the context of the total fund to assess the effect of worst case liquidity scenarios.

Growth Absolute Return:

Individual absolute return fund investments may have specified liquidity parameters defining lock-up periods and withdrawal frequency. Liquidity risk is managed by monitoring and maintaining a schedule of the liquidity of the individual absolute return funds and aggregating it at the total Absolute Return program level.

SCERS may want to take advantage of fee discounts that may be available for funds offering a longer lock-up period or a different share class under certain circumstances and dependent on the underlying characteristics of the absolute return fund. In addition, SCERS may want to invest with absolute return funds that possess strategies where a longer investment horizon is necessary and appropriately matches the illiquidity of the underlying assets invested. While SCERS may want to take advantage of investing in these opportunities, it is not appropriate for the Absolute Return program to consist entirely of illiquid vehicles. Accordingly, guidelines are outlined below to both capture the opportunity set and balance the need for liquidity.

SCERS may invest in absolute return funds that permit voluntary redemptions (Evergreen Portfolio Funds) and absolute return funds that do not permit voluntary redemptions (Self-Liquidating Portfolio Funds).

SCERS shall allocate a minimum of 50% of its capital (at market) to Evergreen Portfolio Funds with quarterly or more frequent liquidity (after applicable “lock ups” expire)

SCERS may not allocate more than 15% of its capital (at cost) to Self-Liquidating Portfolio Funds.

With regard to the capital allocated to Evergreen Portfolio Funds, SCERS may not allocate more than 25% of its Absolute Return capital (collectively, at market) to Evergreen Portfolio Funds that impose a “lock up” (determined either based on the date SCERS first invests in such Evergreen Portfolio Fund or with respect to each investment in such Evergreen Portfolio Fund by SCERS on an investment-by-investment basis, as applicable, and not from the time of any capital commitment to an Evergreen Portfolio Fund) of greater than or equal to 2 years. SCERS may not allocate to Evergreen Portfolio Funds that impose a “lock up” of greater than or equal to 3 years without the consent of SCERS’ Board.

In order to facilitate liquidity, SCERS should reasonably limit exposure to absolute return funds with the ability to use side pockets. Side pocket investments should not exceed 10% of SCERS’ total absolute return portfolio at fair market value.

8. **Distributed Securities:** Within the Public Equity and Public Credit asset classes, SCERS shall typically seek receipt of distributed securities from investment managers. For separate accounts, assets are custodied at SCERS’ custodian, which SCERS can liquidate at its own discretion. For commingled funds, SCERS generally prefers to receive distributed securities, which it can liquidate at its own discretion. The exception is for those funds that require that shares be redeemed from the fund, or if it is more prudent to have a fund redeem shares.

SCERS shall avoid the direct receipt of distributed securities from individual private equity, private credit funds, and absolute return funds. However, if such receipt is unavoidable, SCERS shall ordinarily direct the sale of securities distributed by its investment vehicles as soon as practically possible and strive to not impair the value of the security.

9. **Performance Evaluation:**

- ❖ Performance of the Growth asset category will be evaluated quarterly against the weighted average of the policy index benchmarks outlined in the ‘Benchmarks’ section above.
- ❖ Individual investment vehicle performance will be evaluated on a monthly basis for Public Equities, Public Credit, and Growth Absolute Return, and

on a quarterly basis for Private Equity and Private Credit, compared to the performance of respective peer universes and vintage years (where applicable).

- ❖ It is recognized that immature private investments within closed-end investment vehicles will ordinarily have a 'J-curve effect' whereby there are low to negative returns in the initial years due to the payment of investment management fees during a period when investments are typically carried at cost and returns have not been realized.

10. Investment period to ramp-up: It is recognized that it can take multiple years for segments of the Growth asset category to be fully invested, and that there may be deviations from the previously mentioned targets during the ramp-up period. During the Private Equity and Private Credit asset class ramp-up periods, exposures can be estimated using percentages of committed capital. During the ramp-up period for the Growth asset category, and subsequent to reaching the target allocation, SCERS' Overlay Program will rebalance the Growth asset category to the target allocation, using the designated Growth overlay proxy within the investment guidelines for the Overlay Program.

11. Rebalancing to guidelines: It is anticipated that the majority of changes to rebalance the private market components of the Growth asset category will be made on a long-term basis due to: (1) the general illiquidity of the private investments, which often have investment horizons of 10-15 years; and (2) the significant discount that can be applied if and when private holdings are liquidated in the secondary market. Accordingly, when these guidelines are exceeded, it is anticipated that reducing exposures will be carried out within a long-term time-frame and over a period that is as soon as practical to reflect the illiquidity of many Growth investment vehicles.

SCERS utilizes an Overlay Program, managed by a strategic overlay manager, to equitize cash and to rebalance asset categories within SCERS' total portfolio, including the Growth asset category. The asset categories are rebalanced to target allocations when upper or lower bands are breached. Rebalancing occurs quarterly, unless the respective bands are breached intra-quarter, in which case rebalancing occurs upon the breach of a band.

D. MONITORING

Through the monitoring process, Staff and consultant will extend the initial due diligence into a formal quarterly, semi-annual, and annual process which regularly seeks to determine whether the manager is meeting the Growth asset category's, and its underlying asset classes, investment objectives and other requirements. In the broadest sense, the monitoring process is intended to determine whether the initial reasons for selecting the strategy and investment vehicle remain valid. The monitoring process will disclose whether there has been any material deviation from the investment philosophy and process; the personnel responsible for managing the investment vehicle are still in place; the organization continues to be stable; performance and risk meet expectations; and the investment vehicle manager adheres to its investment and other requirements. The underlying principle of the monitoring program is to determine whether all risks to which SCERS is exposed through the use of outside investment advisors have been identified, understood, and, to the extent possible, controlled. The monitoring process focuses on four areas:

- Compliance with reporting and valuation requirements;
- Continuity of investment philosophy and process;
- Stability of personnel and organization; and
- Performance and risk management.

Staff and consultant will aggregate investment vehicle data and perform analysis on the overall Growth asset category, and its underlying asset classes, paying careful attention to individual investment vehicle allocations and strategy/sector concentrations to strive to achieve proper diversification across the Growth asset category. Staff and consultant will also conduct due diligence with the respective investment vehicle managers to understand the underlying drivers of performance. Additionally, Staff and consultant will conduct portfolio reviews and on-site due diligence as necessary. Site visits will also be performed to confirm that appropriate infrastructure is in place to support the investment process. Staff and consultant will provide the Board with regular performance reports and advise the Board of other matters as appropriate.

If, during the monitoring process, SCERS identifies areas of the Growth asset category that are not compliant with the objectives, guidelines, and constraints, identified in this investment policy statement, then reasonable efforts will be made to cure the deficiency. These reasonable efforts will consider the illiquidity of the asset class and transaction costs to be incurred compared to the risk of non-compliance.

Absolute Return Monitoring

- ❖ **Monitoring risks specific to absolute return funds:** Investing in absolute return funds brings additional risks, which will be managed and mitigated

through a combination of factors including: (1) the asset allocation and guidelines set forth above (diversification across managers and strategies); (2) due diligence of Staff and consultant on individual funds; and, (3) ongoing monitoring and active investment management by Staff and consultant. This includes:

- *Addressing transparency risk*, or the reluctance of absolute return managers to report individual positions, particularly short positions. While absolute return funds may limit transparency at the position level, SCERS' consultant will hold conference calls to review individual absolute return portfolios on a monthly basis. In addition, both the consultant and Staff will be measuring and monitoring exposures in aggregate, e.g. at the level of investment strategy, regions, industries, countries, and portfolio. Leverage, net exposures, and counterparty risk are all monitored at the fund level and portfolio in aggregate.
- *Addressing liquidity risk*, or the inability to redeem immediately from a fund due to hard to value investments, side pockets, lock-ups, and gates. SCERS' consultant monitors the liquidity based on the days to redeem and the individual manager limited partnership agreements. These factors are incorporated into the due diligence process and part of the decision to invest in a particular fund.
- *Addressing operational risk*, or the risk of failure in operations outside of the investment strategy. SCERS' consultant has developed a specific in-house unit to assess a hedge fund's legal, financial statements/audits, compliance, custodian(s), prime broker(s) and other service vendors, operations, administration, trading functions, asset valuation, and conduct background checks. Alongside the consultant's due diligence, Staff will help select absolute return funds by sourcing funds, interviewing managers, and visiting managers on-site to assess the front- and back-offices.
- *Addressing headline risk* (the risk of an absolute return fund attracting negative media attention leading to investors redeeming). Return dispersion and concentration in a niche strategy or concentration in a small number of investments (the risk of any manager's particular strategy not working as in past periods), event risk (the risk of a sizeable investment loss due to a market event, personnel loss, or regulatory issue), are all part of the due diligence and monitoring process and partly mitigated by guidelines and expectations for diversification across managers, strategies, geographies, and industries.
- *Monthly*: Staff will leverage the consultant's monitoring process, a process that requires frequent contact with the absolute return managers. The consultant reviews each absolute return fund's investor communications and calls the absolute return managers monthly to discuss the fund's

organization, strategy, investment process, portfolio characteristics, and performance drivers. Staff will supplement this review process by analyzing the performance and risk of the individual absolute return managers and the overall absolute return portfolio and reviewing absolute return fund investor communications and the consultant monthly reports.

- *Quarterly:* The consultant will produce supplemental quarterly reports that contain performance and risk statistics for the individual absolute return funds and the absolute return portfolio, and portfolio characteristics, including strategy allocations, geographic allocations, and leverage, for the individual absolute return funds and the overall absolute return portfolio.
- *Annually:* The consultant will conduct periodic onsite visits at each absolute return manager's office, but no less frequently than annually. Individual absolute return funds will be re-evaluated annually from both an investment and operational perspective and there will be updated due diligence reports issued. There will be a review of individual absolute return funds' annual audited financial statements. Staff will conduct conference calls with managers and/or conduct on site due diligence at least annually. There will be an annual report re-confirming investment with individual managers and outlining a plan for any Absolute Return portfolio changes/plans for the upcoming year.
- *Other:* The consultant assigns ratings to all absolute return funds as part of its monthly monitoring process. These ratings include placing funds on a "Watch List" where serious organizational or performance concerns exist and the recommendation to terminate a relationship. These investments are not necessarily expected to lose money over their life, but in the opinion of the consultant there is a more likely chance that returns will fall short of expectations. Watch List funds are subject to more intense scrutiny. The consultant will provide Staff with a Watch List report for any absolute return placed on the Watch List. As a final step, the consultant may recommend that Staff exit (redeem) from the fund investment. Absolute return funds can have redemption features that require notification months in advance or limitations such as gates, penalties, and side pocket restrictions. The consultant will assist Staff in developing an exit strategy. A final recourse would be to seek a secondary sale if redeeming is not possible.

E. IMPLEMENTATION PROTOCOL

The following implementation protocol describes the allocation of investment authority and responsibilities between SCERS' Board, Staff, and consultants. Overall, the Growth asset category implementation protocol delegates the most time intensive elements of the process to Staff and consultant, while preserving the Board's oversight of the overall Growth asset category and its underlying asset classes.

The Board will approve the long-term Asset Allocation Structure for the individual asset classes within the Growth asset category, as developed and presented by Staff and Consultant. These include Domestic Equity, International Equity, Private Equity, Public Credit, Private Credit, and Growth Absolute Return. The long-term Asset Allocation Structure for underlying Growth asset classes will articulate the long-term direction and objectives of each asset class including elements such as: (1) asset allocation targets and ranges by strategy, geography and style (for Public Equities), and types of investment vehicles; (2) for Private Equity, Private Credit, and Growth Absolute Return, a target range for the number of investment managers; and, (3) for Private Equity, Private Credit, and Growth Absolute Return, the role of Fund of Funds and strategic partners.

On an annual basis, the Board will approve the Annual Investment Plan for the individual asset classes within the Growth asset category. The Annual Investment Plan will articulate the direction over the next year in taking the necessary steps to achieve the above objectives of the long-term Asset Allocation Structure of the underlying asset classes.

The execution of the long-term Asset Allocation Structure and Annual Investment Plan will vary between that of Public Equity and Public Credit, and that of Private Equity, Private Credit, and Absolute Return.

1. Public Equity and Public Credit:

Overall, the Public Equity and Public Credit implementation protocol delegates the most time intensive elements of the process to Staff and consultant, including the screening and evaluation leading to the recommendation to engage or terminate a particular investment manager. The Board provides oversight of the overall Public Equity and Public Credit programs and makes the final decision regarding engagement or termination of investment managers.

The key features of the Public Equity and Public Credit implementation protocol are as follows:

- ❖ If Staff and the consultant believe that a change is necessary to the manager structure in order to obtain optimal performance from the asset class, Staff and the consultant will present the Board with a report

- outlining the basis for their conclusion including how the change under consideration would fit within: (a) the allocation model for the asset class approved by the Board; and (b) the annual investment plan approved by the Board.
- ❖ Staff and the consultant will then identify the most qualified candidates to bring into the manager structure based on the full range of relevant factors regarding the manager, its investment team, and strategy. Staff will prepare a report for the Board outlining why the managers in question have been identified for closer evaluation for a possible commitment. The consultant will also provide investment strategy and operational due diligence reports.
 - ❖ Staff and the consultant will pursue more extensive due diligence on the manager candidates, including conducting extended interviews with the portfolio managers and other key members of the investment team. Legal counsel will begin reviewing the documentation for the possible engagement and preliminary negotiation of deal terms will take place.
 - ❖ If/When: (a) the due diligence process is completed; (b) deal terms have been determined; (c) staff and the consultant have determined which manager to recommend to the Board; then (d) staff will prepare a report to the Board outlining the basis for the decision, the proposed commitment amount, and the target date for closing on the commitment.
 - ❖ At any point in the process, questions or concerns by a Board member regarding a proposed investment or proposed manager can be communicated to the Chief Executive Officer (CEO). The CEO will be responsible for assuring that a prompt response is provided. The CEO will also provide the full Board with the response. If the Board member is not satisfied with the response, the Board member can request that the matter be brought to the full Board for consideration. In such a case, the CEO will refer the matter to the Board President who will determine whether the manager search process should be suspended until the matter is resolved. As a general rule, it is anticipated that the process of identifying and vetting a proposed investment will take place over a period of time sufficient to allow, if necessary, for full Board consideration of questions or concerns before a recommendation is finalized.
 - ❖ The manager being recommended for the engagement will make a presentation to the Board. At that time the Board can address any questions or concerns regarding the recommended candidate as well as any previously raised questions or concerns regarding another candidate or candidates. The Board can (a) approve engagement of the recommended manager; (b) direct that one or more alternative candidates be brought forward for consideration; (c) request further information regarding a candidate or candidates; or (d) take any other action the Board deems appropriate.

- ❖ If the new investment manager engagement also involves the recommended termination of an existing manager, Staff and the consultant will develop and report to the Board on the reasons, timeline and plan for terminating the existing engagement, and transitioning the assets from the outgoing manager to the incoming manager. The Board will take action on the recommended termination.
- ❖ If Staff and the consultant determine that it would be advisable to physically re-balance the portfolio at the same time as making the investment manager structure changes, Staff and consultant will prepare a report for the Board outlining the recommended physical re-balancing and why it is necessary and appropriate. The Board will take action on the recommended physical re-balancing.
- ❖ Upon approval by the Board: (a) the new investment engagement will be finalized and the necessary documentation executed; (b) the engagement with the outgoing manager will be terminated; and (c) the transition plan, and any necessary physical re-balancing, will be implemented.
- ❖ SCERS' Board President or Chief Executive Officer are authorized to execute any and all documents which may reasonably be required to complete a new investment engagement, to terminate an engagement with an outgoing manager, and to effectuate a transition of assets on behalf of SCERS.
- ❖ Staff and the consultant will report to the Board when the manager structure changes and any necessary re-balancing have been completed, along with an analysis of the costs associated with the transition.

2. Private Equity, Private Credit, and Growth Absolute Return:

For the Private Equity, Private Credit, and Growth Absolute Return asset classes, the execution of the long-term Asset Allocation Structure and Annual Investment Plan including the selection of investment managers will be delegated to Staff, subject to the Board's ability to review, discuss, and object to the recommendations of Staff and consultant during the investment protocol process.

The key features of the proposed Private Equity, Private Credit, and Growth Absolute Return investment protocol are as follows:

- Staff and consultant will identify the most qualified candidates for a prospective private equity, private credit, or growth absolute return investment commitment based on: (a) the Asset Allocation Structure for the underlying asset classes approved by the Board; and (b) the Annual Investment Plan for the underlying asset classes approved by the Board

(which takes into account SCERS' existing private equity, private credit, and growth absolute return investments and prioritizes and targets optimal new investment opportunities that complement those investments, and in the case of private equity and private credit, are expected to come to market in the next twelve months).

- When a particular manager candidate is identified, Staff and consultant will pursue extensive due diligence on the manager candidate, including conducting extended interviews with the portfolio managers and other key members of the investment team.
- The consultant will complete its investment strategy and operational due diligence reports, if they have not done so already. Legal counsel will begin reviewing the documentation for the possible commitment amount (private equity; private credit) / investment amount (growth absolute return), and preliminary negotiation of deal terms will take place.
- Staff will prepare a detailed report for the Board outlining the basis for the potential commitment/investment, the contemplated commitment/investment amount, the target date for closing on the commitment/investment, and an assessment of the fit within SCERS' portfolio. The report will include an evaluation of the organization, investment strategy, considerations and risks, and track-record, as well as an operational assessment and a review of the investment's terms.
- If/When: (a) the due diligence process is completed; (b) deal terms have been determined; (c) staff and consultant have concluded that a commitment/investment should be made; then (d) staff will prepare a final report for the Board outlining the basis for the decision, the proposed commitment/investment amount, and the target date for closing on the commitment/investment. The final report will summarize the due diligence items that have been completed in order to move forward with a commitment/investment, as well as any considerations that have arisen since the issuance of the initial reports by Staff and the consultant.
- At any point in the process, questions or concerns by any trustee regarding a proposed investment or proposed manager will be communicated to the Chief Executive Officer (CEO). The CEO will be responsible for assuring that a prompt response is provided. The CEO will also provide the full Board with the response. If a Board member is not satisfied with the response, the Board member can request that the matter be brought to the full Board for consideration. In such a case, the CEO will refer the matter to the Board President who will determine whether the manager search process should be suspended until the matter is resolved. As a general rule, it is anticipated that the process of identifying and vetting a proposed investment will take place over a period of time sufficient to allow, if necessary, for full Board consideration of questions or concerns before a commitment is finalized.

- Absent questions or concerns by the Board, the proposed investment will be finalized and the necessary documentation executed, and in the case of growth absolute return, funds placed with the manager.
- SCERS' Board President or Chief Executive Officer are authorized to execute any and all documents which may reasonably be required to complete any Private Equity, Private Credit, or Growth Absolute Return investment on behalf of SCERS.
- Staff and consultant will confirm that the commitment/investment has been made, and the amount allocated to SCERS, at a subsequent Board meeting.
- Because management of the aggregate Absolute Return portfolio is dynamic and ongoing, Staff and the consultant will also have authority to make adjustments to the Growth Absolute Return portfolio in order to assure that the portfolio is optimally aligned to achieve the objectives of the asset class. This includes, but is not limited to the authority to: (1) trim or add to existing investment mandates; (2) terminate and/or replace an existing manager; (3) submit redemption requests; (4) determine the appropriate sources for funding a new mandate or adding to an existing mandate; and (5) determine the appropriate application of any returned capital.
- If and when Staff and consultant determine that such actions are necessary, a timely report will be prepared outlining why the action is/was deemed necessary and how it impacts SCERS' Absolute Return portfolio. Notice will be promptly provided to the Board regarding the action and the report will be put on the secure Board website.

F. POLICY HISTORY

<i>Date</i>	<i>Description</i>
10-20-2011	Board adopted Hedge Fund asset class investment policy statement
07-10-2014	Board adopted Equity asset class investment policy statement
07-10-2014	Board adopted Fixed Income asset class investment policy statement
04-19-2017	Board adopted Private Equity asset class investment policy statement
06-21-2017	Board adopted Private Credit asset class investment policy statement
11-05-2018	Board adopted reformatted and consolidated Growth asset category investment policy statement

03-20-2019	Amended Growth asset category investment policy statement
03-18-2020	Amended Growth asset category investment policy statement