



TITLE: Investment Policy

BOARD ADOPTION: October 13, 2016

EFFECTIVE DATE: January 1, 2017

I. PURPOSE

This Investment Policy provides a framework for the management of the investment assets of the Seattle City Employee's Retirement System (SCERS). Its purpose is to guide and assist the Board of Administration (the "Board") in selecting, monitoring and managing the investments of SCERS (the "Fund") to fulfill its mission and deliver the retirement benefits its members have earned. The Investment Policy will specifically address:

- Goals of the investment program;
- Investment beliefs of SCERS;
- Strategic asset allocation policy and permissible asset classes;
- Other policies related to the management of the Fund; and
- Responsible parties.

The Investment Policy is established in accordance with the Revised Code of Washington (RCW), Section 35.39.060 (and the Seattle Municipal Code, Section 4.36.500.F) which provides:

Any city or town now or hereafter operating an employees' pension system with the approval of the board otherwise responsible for management of its respective funds may invest, reinvest, manage, contract, sell, or exchange investments acquired. Investments shall be made in accordance with investment policy duly established and published by the board. In discharging its duties under this section, the board shall act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims; shall diversify the investments of the employees' pension system so as to minimize the risk of large losses; and shall act in accordance with the documents and instruments governing the employees' pension system, insofar as such documents and instruments are consistent with the provisions of this title.

Consistent with the requirements of RCW 35.39.060 and SMC 4.36.500.F, this Investment Policy allows for sufficient flexibility in the management of investments for the Board to seek the best expected results for the Fund consistent with prudent levels of risk and other relevant factors.

II. GOALS

SCERS's investment goals are as follows:

- Overall, provide benefits to SCERS members and their beneficiaries through consistent contributions made by both employer and employees and a carefully planned and executed investment program.
- Over a timeframe of 30 years, to achieve a total return net of all investment management fees and expenses that matches or exceeds the actuarial rate of return as adopted periodically by the Board.
- Over a timeframe of 5 to 7 years that is typical of a market cycle, to achieve a total return net of all investment management fees and expenses that matches or exceeds the Fund policy index.

III. BELIEFS

The Board maintains the following investment beliefs:

- A. SCERS is a long-term investor; having this perspective allows the Board to pursue investments that may experience short-term fluctuations, but are expected to deliver sustainable value in the long run.
- B. Since SCERS is unable to predict the future, holding a well-diversified portfolio is a prudent course of action; it allows the Fund to have risk allocated across multiple asset classes, investment styles, investment strategies, geographic regions, and Investment Managers (“Managers”).
- C. Investors are compensated over the long run for taking on the relatively higher risk of investing in equities and other assets that are materially impacted by changes in economic growth. However, bearing this risk will result in variable performance and periodic losses.
- D. Among the wide variety of factors affecting investment returns, the Fund’s total return is affected more significantly by strategic asset allocation decisions than by manager selection and tactical asset allocation decisions, which play less significant roles.
- E. Direct costs (e.g. management fees, carried interest, commissions, transaction costs, etc.) diminish the Fund’s performance; therefore, these costs must be carefully considered and closely monitored throughout all of the Fund’s investment activities. Holding cash is seen as an opportunity cost to market exposure, therefore, we should generally seek to limit this potential impact on performance.
- F. Both investment and operational risks must be clearly identified, closely examined, and appropriately addressed when making investment decisions to manage overall risk of the Fund. However, taking investment risk is a requirement in order to generate the return that SCERS requires to meet its obligations.
- G. Passive investing is often expected to outperform active management on a net of fee basis in markets that are highly efficient. Where there are indications of inefficiencies, active management may be beneficial to exploit these opportunities. However, pursuing active management requires the identification of managers with robust resources and capabilities to successfully execute their strategies and achieve superior net of fee returns in relation to passive investing.
- H. Performance of the Fund, its asset classes, and Managers must be evaluated on a regular and consistent basis against applicable and appropriate benchmarks, including market indices and peer universes.
- I. It is imperative to ensure that the interests of SCERS’s service providers (for example, its Managers and Consultant) are aligned with SCERS’s interests, in order to ensure that SCERS’s best interests are not compromised in any investment, administrative, or other matter.

IV. ASSET ALLOCATION

The Board adopts and implements a strategic asset allocation that is predicated on a number of factors, including, but not limited to:

- Historical and expected long-term capital market assumptions to assess the risk, return and correlation behavior of asset classes;
- A projection of actuarial assets and liabilities to determine the current and projected funding status, and future benefit payments and contributions to gauge the Fund’s required liquidity; and
- An assessment of potential economic scenarios, including inflation and interest rate levels, to evaluate the expected impact on the Fund’s performance.

The strategic asset allocation will be determined through appropriate studies undertaken by the Investment Consultant (“Consultant”) retained by the Board. The asset allocation study will include all asset classes deemed prudent and appropriate by the Board. The Board, with the aid of the Consultant and Staff, will determine the assumptions and criteria to be used in the asset allocation study. The asset allocation study will be performed no less frequently than every five years. Appropriate adjustments to the existing portfolio will then be made in a timely and appropriate manner.

On a periodic basis, Staff, with assistance from the Consultant, will analyze the portfolio structure of each asset class. This analysis shall include: 1) appropriateness of asset class and manager benchmarks, 2) alignment structure of individual portfolios with asset class benchmarks based on Manager holdings and mandates, 3) evaluation of whether the asset class is structured in such a manner that is consistent with SCERS’s objectives, and 4) overall risk profile of the asset class.

Pursuant to RCW 35.39.060, which requires the diversification of the Fund so as to minimize the risk of large losses, the Fund shall be diversified according to the specified target percentages:

Strategic Asset Allocation

Asset Class	Sub-Asset Class	Target
Equity	Public	48%
	Private	9%
Fixed Income	Core	16%
	Credit	7%
Real Assets	Real Estate	12%
	Infrastructure	3%
Diversifying Strategies		5%

The Board believes that this represents one of many prudent and permissible asset allocation strategies to achieve diversified investment returns, and anticipates changes to this allocation as circumstances warrant. In addition, periods of transition may be necessary to establish and maintain the target level of investment in each asset class, particularly with respect to less liquid investment private market asset classes.

The Board will utilize the following asset classes as it seeks to meet SCERS’s investment goals:

A. Equity

The equity asset class includes investments that represent ownership stakes in companies. Equity is generally expected to perform well in periods of accelerating economic growth and poorly in periods of declining economic growth. The Board expects that over the long run, equities will generate the highest total return of any asset class, but may be subject to substantial volatility over shorter periods. Eligible sub-asset classes within equities include:

- **Public:** Public equity represents shares in companies that are listed on public market exchanges. The Board seeks to diversify SCERS’s public equity investments by geography, size, sector, style and company in a manner that approximates the composition of the global equity market. In so doing, SCERS will own shares of companies based in the United States, other developed market countries and emerging market countries. The Board may choose to pursue *passive*, *active* or *style* strategies in the Fund’s public equity allocation.
- **Private:** Private equity generally represents investments in privately owned companies that are not listed on public market exchanges. Private equity investments are significantly less liquid than those of public equity and are typically accessed through partnerships that are managed by external general partners. The Board seeks to diversify SCERS’s private equity investments by geography, sector and general partner. Sectors may include venture capital, growth equity, buyout, mezzanine debt and distressed debt. Given its private nature, only active strategies may be pursued in private equity investments.

B. Fixed Income

The fixed income asset class includes investments in debt where the borrower may be governments, companies or other parties. The Board expects that over the long run, fixed income will provide an appreciably lower but more stable return than equities with less sensitivity to changes in economic growth. The Board may choose to pursue passive or active strategies in the Fund's fixed income allocation. Eligible sub-asset classes within fixed income include:

- **Core:** Core fixed income represents debt investments that are primarily rated investment grade. The Board seeks to diversify SCERS's core fixed income investments by maturity and sector in a manner that approximates the composition of the U.S. dollar denominated investment grade fixed income universe. Sectors may include U.S. treasuries, U.S. agencies, investment grade corporate bonds, mortgage-backed securities and other securitized assets.
- **Credit:** Credit fixed income represents debt investments that typically have lower credit quality and a higher associated risk of default. As compensation for this risk, credit fixed income is expected to offer a higher yield. The Board seeks to diversify SCERS's fixed income credit investments by debt issuer, but expects some level of sector concentration due to the more granular nature of the sub-asset class. Sectors may include high yield bonds, bank loans, private debt, emerging markets debt, securitized assets and convertible bonds.

C. Real Assets

The real assets asset class includes investments that are tangible and produce inputs into the economy. Real assets are expected to provide cash flow and some protection against unexpected inflation with a moderate sensitivity to changes in economic growth. The Board expects that over the long run, real assets will provide a total return and risk profile between fixed income and equity investments. Real assets are typically less liquid than those of public equity or fixed income. The Board expects that only active strategies will be pursued in SCERS's real assets allocation. Eligible sub-asset classes within real assets include:

- **Real Estate:** Real estate represents investments in commercial properties in sectors such as retail, office, multi-family and industrial. The Board expects the majority of SCERS's real estate allocation to be in core U.S. equity, although investments in non-core, non-U.S. or debt are permissible. The Board seeks to diversify SCERS's real estate investments by sector and region with consideration of the U.S. investable real estate universe. Public real estate securities, such as real estate investment trusts, are also permissible.
- **Infrastructure:** Infrastructure represents investments in tangible assets in sectors such as regulated utilities, transportation, power generation and social infrastructure. The Board expects the majority of SCERS's infrastructure allocation to be in privately owned equity investments, although public securities or debt investments are permissible. The Board expects to diversify SCERS's infrastructure investments by sector, region and stage of development, although there may be greater concentration than in other asset classes given the emerging and granular nature of infrastructure investments.

D. Diversifying Strategies

The diversifying strategies asset class includes investment strategies that are expected to have low to moderate sensitivity to changes in economic growth and an outsized potential for excess returns by affording greater flexibility to Managers. In so doing, diversifying strategies are expected to increase the Fund's risk-adjusted performance. The Board generally expects diversifying strategies to provide a total return and risk profile between fixed income and equity, while recognizing that this asset class places a greater importance on selecting Managers that achieve attractive risk-adjusted performance.

V. GENERAL POLICIES

A. Laws and Regulations

In pursuing its investment program, SCERS shall at all times comply with applicable local, state and federal laws and regulations.

B. Rebalancing Guidelines

As market values change over time, the actual asset mix of the Fund may diverge from the target allocations established by the Board through the asset allocation process. If the Fund is allowed to deviate too far from the target allocations, there is a risk that the Fund will fail to meet the management objectives set by the Board. On the other hand, too frequent of portfolio rebalancing to the asset allocation targets may result in material transaction costs. Cognizant of these risks, Staff will rebalance the Fund in accordance with the following guidelines and procedures as established by the Board:

- With respect to each asset class for which the Board has set a target allocation, the Board, in consultation with Staff and Consultant, will establish rebalancing range limitations. These rebalancing ranges are subject to adjustment in response to changed circumstances and recommendations by Staff and the Consultant.

Strategic Asset Allocation Rebalancing Ranges

Asset Class	Sub-Asset Class	Min	Target	Max
Equity	Public	43%	48%	62%
	Private	0%	9%	12%
Fixed Income	Core	12%	16%	22%
	Credit	4%	7%	10%
Real Assets	Real Estate	9%	12%	15%
	Infrastructure	0%	3%	5%
Diversifying Strategies		0%	5%	8%

- Staff will monitor the Fund's asset allocation relative to target allocations and ranges on a periodic basis. If the actual allocations fall within the defined ranges, no rebalancing will be required, but Staff will have the discretion to rebalance to manage portfolio risk relative to policy. In the rare event that actual allocations for a publicly traded asset class fall outside the predetermined ranges, Staff will alert the Board and develop a plan for rebalancing back within the target range, including the timeframe for accomplishing the rebalancing.
- The Board may engage a Manager to manage an overlay program where the Fund is rebalanced through the use of futures and other derivative instruments.
- Whenever an allocation to a particular asset class is above or below target, but within the target range, Staff or the Manager of the overlay program may rebalance partially or fully back to the target where there is an opportunity to do so effectively.
- Given the difficulty in managing the allocation to less liquid private market asset classes (i.e. private equity, real estate, infrastructure), automatic rebalancing will not be required if the actual allocation for such assets falls outside the predetermined range. Rather, Staff, in consultation with the Consultant and/or Managers, will develop a plan to bring the allocation as close as practicable to the policy target within a prudent timeframe. In the interim where private equity is above or below target, public equity will act as a counterweight and be correspondingly held below or above target, respectively, by a like amount. In the interim where the aggregate real assets allocation is above or below the aggregate target, an equal combination of public equity and core fixed income will act as a counterweight and be correspondingly held below or above target, respectively, by a like amount.
- Given the difficulty in identifying and accessing diversifying strategies that are expected to increase portfolio

risk-adjusted performance, the actual allocation for such assets may fall below the target allocation for extended periods of time. In such instances where the allocation to diversifying strategies is below target, an equal combination of public equity and core fixed income will act as a counterweight and be correspondingly held above target, respectively, by a like amount.

C. Performance Indices

The performance goal for each asset class in which SCERS is invested shall be to achieve a total return net of fees and expenses which equals or exceeds the market indices listed below over a 5 to 7 year timeframe that is typical of a full market cycle.

Asset Class Policy Indices

Asset Class	Sub-Asset Class	Index
Equity	Public	MSCI All Country World Investable Market Index
	Private	Custom Private Equity Index*
Fixed Income	Core	Barclays Capital U.S. Aggregate Index
	Credit	Custom Credit Index**
Real Assets	Real Estate	NCREIF NFI ODCE Index
	Infrastructure	CPI + 3%
Diversifying Strategies		HFRI Fund of Funds Composite Index

*Custom Private Equity Index is defined as the Burgiss All Private Equity Universe that is weighted by vintage year to generally reflect the anticipated composition of the Fund's private equity program

**Custom Credit Index is defined as 40% Merrill Lynch High Yield Master II Index, 40% Credit Suisse Leveraged Loan Index, 10% JPM EMBI Global Diversified Index and 10% JPM GBI-EM Global Diversified Index

The performance goal for the Fund is based on a weighted average of the asset class policy indices. While it is the Board's desire to reach the target allocation in an expedited and prudent manner, it is anticipated that it will take time to do so for the private market asset classes. The Fund policy index reflects this by increasing the percentage attributed to the asset class policy indices for private markets (and decreasing those for the corresponding public markets) based on the anticipated pacing plan.

Fund Policy Index Composition

Index	2017	2018	2019	2020
MSCI All Country World Investable Market Index	54.5%	53.0%	51.5%	50.0%
Custom Private Equity Index	4%	5%	6%	7%
Barclays Capital U.S. Aggregate Index	17.5%	17.0%	16.5%	16.0%
Custom Credit Index	7%	7%	7%	7%
NCREIF NFI ODCE Index	10%	11%	11%	12%
CPI + 3%	2%	2%	3%	3%
HFRI Fund of Funds Composite Index	5%	5%	5%	5%

D. Watch Status

The Board may place a Manager on watch status if at least one of two events occurs: (i) investment performance does not meet the objectives outlined in this Investment Policy or the individual Manager contract; or (ii) Staff and/or Consultant, as part of their ongoing monitoring process, identify a material concern that warrants closer and continued scrutiny. If the Board places a Manager on watch status, Staff will issue a formal notification to the Manager. Typically, once a Manager is placed on watch status, it should be able to exhibit improvement within a timeframe of twelve to eighteen months, or such date as specified by Staff or the Consultant.

The Board, in consultation with Staff and the Consultant, may release a Manager from watch status if they exhibit improvement with respect to the events that caused it to be placed on watch status. A Manager is not required to be on watch status for the Board to proceed with termination. The Board may terminate any Manager or reduce its allocation of the Fund's assets if the Board, in its sole discretion, determines that doing so is prudent and appropriate.

E. Manager Concentration

No single Manager shall manage, in aggregate across all mandates, more than 30% of the Fund. When excluding those mandates that are passively managed, no single Manager shall manage more than 15% of the Fund. For purposes of mandates where investment decision-making is delegated to a sub-advisor, this concentration limit will consider the sub-advisor as the Manager.

F. Securities Lending

An agreement may be made with SCERS's Custodian or other third-party custodian retained by the Board to loan securities on behalf of SCERS. Securities lending is intended to generate incremental income within a high-quality investment program that safeguards the return of principal, maintains adequate daily liquidity and ensures diversification. Securities that are loaned shall be fully collateralized in cash or other acceptable securities having at least 102% of the market value of the loaned security.

G. Derivatives

Manager use of derivative instruments is permitted if specifically allowed under the Manager contract and only for purposes of substitution or risk control. Derivative use for the purposes of speculation or arbitrage is not permitted. For these purposes, derivatives shall be defined as securities whose return or market value is derived from another security or market index.

H. Proxy Voting

The Board recognizes that proxy voting rights are assets of the Fund that allow SCERS to participate in the governance of corporations in which it is directly invested. In managing this asset, the Board may: (1) give authority and discretion to Managers or Staff to vote proxies on behalf of SCERS; (2) instruct Managers to vote proxies as directed by a third-party provider; or, (3) require Managers to vote proxies at its direction. Managers must vote proxies in a timely manner and maintain accurate records of all proxy voting activity.

Staff will monitor the voting activities of the Managers on at least an annual basis.

I. Environmental, Social and Governance Considerations

See separate Environmental, Social, and Governance Policy and Procedure.

J. Conflicts of Interest

See separate Conflicts of Interest for Managers and Placement Agents Policy.

VI. DUTIES AND RESPONSIBILITIES

A. Duties of the Board

Although it is not the intent of the Board to be involved in the day-to-day investment activities, it is responsible for SCERS and its investments. The Board may establish an Investment Committee to assist the Board. The Board will adhere to the following procedures in the management of the Fund:

- In consultation with Staff, the Consultant, and legal counsel, develop, approve, and periodically review policies and practices to govern the execution of the investment program. Staff will be responsible for implementation and administration of these decisions.
- Establish and periodically review the strategic asset allocation for the Fund. Staff and the Consultant shall assist the Board in these decisions.
- Select, manage, review, and terminate Managers, the Consultant, and the Custodian. Staff shall assist the Board in these decisions; the Consultant shall assist in selection, management, review, and termination of Managers.
- Review the investment portfolio on at least a quarterly basis, including an assessment of performance as compared to this Investment Policy and peer funds.

B. Duties of the Staff

The Board's Staff provides analysis and recommendations to the Board on investments and related matters; oversees and directs the implementation of Board policies, and manages the Fund on a day-to-day basis. Further, Staff shall:

- Conduct Manager search processes, as approved by the Board, with assistance from the Consultant as needed.
- Evaluate and manage the relationships with Managers, the Consultant, and the Custodian to ensure that they are serving SCERS well.
- Monitor and evaluate Managers for such matters as adherence to SCERS's policies and guidelines.
- Manage portfolio restructuring, portfolio rebalancing, and investment reallocations or Manager terminations, with the assistance of the Consultant and Managers, as needed.
- Initiate and perform any special research requested or required by the Board.
- Advise and keep the Board apprised of other investment matters.

C. Duties of the Consultant

The Consultant shall be responsible for the following:

- Make recommendations to the Board, in collaboration with Staff, regarding investment policies and procedures, and strategic and tactical asset allocation matters.
- Assist the Board and Staff in the selection of qualified Managers, and assist in the review of existing Managers, including monitoring changes in personnel, ownership and their investment processes.
- Provide topical research and education on investment subjects as required or requested by the Board or Staff.
- Prepare a performance report at least quarterly assessing the performance of the Fund, its asset classes, and its Managers in relation to this Investment Policy, relevant performance indices, and peer funds.

D. Duties of the Managers

Each Manager is responsible for all aspects of portfolio management as set forth in its contract with SCERS and shall be responsible for the following:

- Manage SCERS's assets under its care, custody and/or control in accordance with the objectives and guidelines in this Investment Policy and the Manager's specific contract.
- Acknowledge and agree to accept fiduciary responsibility in safeguarding and managing SCERS's assets under its control, and in complying with this Investment Policy.
- Adhere to the investment management style concepts and principles for which they were retained.
- Obtain best execution for all transactions by considering such factors as execution capabilities required by the transaction, cost, speed, efficiency and confidentiality, and, where appropriate, facilitate soft dollar credits (i.e. payment of services through commissions) and the recapture of commissions for SCERS's benefit.
- Monitor and evaluate performance relative to the established objectives that are defined by the Board based on the Manager's asset class and style and as specified in the Manager's contract.
- Notify Staff in the event of any significant change in investment style, firm ownership, senior personnel, or the mandate's portfolio manager or relationship manager.
- Maintain frequent and open communication with Staff on all significant matters pertaining to the investment program, including, but not limited to, performance, portfolio structure and organizational matters.
- Meet with the Board, Staff, and/or Consultant on an as-needed basis.

E. Duties of the Custodian

The Custodian shall be responsible to the Board for the following and such other responsibilities set out in its contract with SCERS:

- Provide complete global custody and depository services for the designated accounts.
- Acknowledge and agree to accept fiduciary responsibility in safeguarding and recordkeeping of SCERS's assets.
- Collect all income and realized principal and accurately report it on the periodic statements.
- Provide in a timely and effective manner monthly and fiscal year-end accounting statements for the portfolio, including all transactions.
- Provide assistance to SCERS in completing such activities as the annual audit, transaction verification and unique issues as required by the Board.
- Manage a securities-lending program to enhance income if directed by the Board and report on the program to Staff on a periodic basis.

F. Duties of the Investment Advisory Committee

The Investment Advisory Committee shall be responsible for the duties outlined in RCW 35.39.090:

- Make recommendations as to general investment policies, practices, and procedures to the Board.
- Review the investment transactions of the Board annually.
- Prepare a written report of its activities during each fiscal year.

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