Stanislaus County Employees' Retirement Association



Investment Policy Statement

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The Stanislaus County Employees' Retirement Association ("StanCERA") is a public employee retirement system that was established by the County of Stanislaus on July 1, 1948. StanCERA is administered by the StanCERA Board of Retirement ("the Board") to provide service retirement, disability, death and survivor benefits for county employees and other participating agencies under the County Employees Retirement Law of 1937, California Government Code Section 31450 *et. seq.* (CERL) and the California Public Employees' Pension Reform Act of 2013, California Government Code Section 7522 *et. seq*. (PEPRA) and other applicable laws.

1. Purpose

StanCERA has established an investment program ("Investment Program") designed to provide sufficient assets in a timely manner to pay the benefits due to participants today and in the future, over the long-term. The purpose of this Investment Policy Statement ("IPS") is to establish the policies that will guide the Investment Program. This IPS is intended to provide guidance to the Board and to its delegates, the Staff and third-party professionals. This IPS is supported by the Board's Investment Directives, the Investment Processes ("Processes"), and other Board policies that reflect the needs of the defined benefit plan ("Plan") that the Board administers. The Investment Directives, policies and other Board documents hereto are incorporated into this IPS and made a part hereof by this reference.

2. Authority

The Investment Program shall be managed in accordance with applicable law, including but not limited to the following:

- The assets of the Plan are trust funds and shall be held for the exclusive purposes of providing benefits to the participants in the Plan and their beneficiaries and defraying reasonable expenses of administering the Plan (Cal. Const. art. XVI, sec. 17(b); Cal. Govt. Code sec. 31595).

- The Board and its officers and employees shall discharge their duties with respect to the system:
  a) Solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system.
  b) With the care, skill, prudence, and diligence under the circumstances prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims.
  c) Shall diversify the investments of the system so as to seek an appropriate risk-adjusted rate of return consistent with the financial characteristics of the sponsors, unless under the circumstances it is clearly prudent not to do so.

  (Cal. Const. art. XVI sec. 17(b), (c) and (d); Cal. Gov. Code Sec. 31595 (a), (b) and (c)).

3. Governance

The Board hereby adopts a governance model whereby specific authority, responsibility, and accountability are either retained by the Board or delegated to others based on areas of expertise and appropriate oversight. The Board retains sole responsibility governing the Plan, setting investment policy, and oversight and monitoring the Investment Program. It may choose to delegate specific areas of responsibility provided it retains appropriate oversight of the delegated activity.

A. Roles and Responsibilities

1. BOARD OF RETIREMENT

The Board maintains the sole and plenary authority and fiduciary responsibility for the Investment Program. The Board also understands it may delegate certain responsibilities under the Investment Program for purposes of administrative efficiency and expertise. The areas of the Investment Program the Board may not delegate include:

- The governance model of the Investment Program
- Establishing and maintaining investment policy, including:
  - Investment philosophy
  - This IPS
  - Investment objectives
  - Strategic asset allocation
  - Allocation-level performance benchmarks
  - Risk philosophy
- Engaging Board consultants and service providers
- Monitoring the Investment Program

With respect to the Private Markets Portfolio, the Board additionally retains responsibility for the following:

- Approving the Private Markets investment policy framework as incorporated within this IPS and supporting directives
- Reviewing the Private Markets Annual Investment Plan, which establishes the Investment Program's annual commitment strategy across private markets sub-asset classes.
- Reviewing and approving all Private Markets investments with individual commitments that exceed Investment Staff's delegated commitment authority, as described in Directive # 2.
- Providing oversight of the Private Markets portfolio, including performance, risk, and policy compliance

2. STAFF

StanCERA Staff ("Staff") is broadly responsible for supporting the Board in the effective execution of its fiduciary duties. The Executive Director, or their designee,

has been delegated authority to execute specific elements of the Investment Program as outlined in this or any other approved investment-related policies.

For purposes of this document, "Investment Staff" shall be defined as the Executive Director and anyone in the Retirement Investment Officer classification.

Investment Staff shall monitor this IPS and recommend changes, with input from the Consultant(s), to the Board, as appropriate.

In addition to its general responsibilities, Investment Staff shall be responsible for oversight of the private markets portfolio. Investment Staff's responsibilities in this regard include:

- Developing and recommending to the Board all necessary changes to the Private Markets investment guidelines and related Directives, with input from the Consultant
- Developing and maintaining specific operational procedures, as necessary, to implement the Board-approved Private Markets investment guidelines
- Approving Private Markets investment commitments within delegated authority thresholds following completion of a thorough and satisfactory due diligence process
- Monitoring the Private Markets Portfolio for performance and compliance with the Board-approved investment guidelines and applicable Directives
- Monitoring the performance of the underlying Private Markets Investment Managers and their compliance with (a) the investment guidelines as set forth in their respective contracts; (b) the Board-approved Private Markets investment guidelines; and (c) applicable requirements of this IPS, Investment Directives, and procedures.
- Conducting periodic reviews of the Private Markets Portfolio.
- Reporting to the Board any material violations of the Private Markets investment guidelines with appropriate recommendations.
- Assisting StanCERA's counsel in contract negotiations with selected Private Markets Investment Managers.
- Evaluating Private Markets investment opportunities on an ongoing basis, with input from the Consultant.
- Evaluating and making recommendations to the Board regarding the retention and termination of Private Markets Investment Managers.

3. GENERAL INVESTMENT CONSULTANT

The General Investment Consultant ("Consultant") is engaged by the Board to provide independent, objective investment advice. The Consultant is and shall agree to be a fiduciary to the Plan under California law. The Consultant works with Staff in the development of recommendations while recognizing its fiduciary duty is to provide prudent investment advice to the Board. The Consultant provides advice without

discretionary authority to execute on its advice. The specific duties of the Consultant are contained in the Revised Model Agreement for Investment Consulting Services, and generally include providing advice with respect to:

- Investment strategy development and implementation
- Investment policy development
- Asset allocation among classes and subclasses
- Investment manager selection, evaluation and termination
- Investment performance monitoring
- Investment risk monitoring
- Investment fee analysis and negotiation
- Capital markets projections
- Coordination with the Plan's actuary in conducting periodic asset/liability studies and other required reporting
- Board education

4. SPECIALTY INVESTMENT CONSULTANTS

Specialty consultants may be hired by the Board to work with Staff, the Consultant, and/or the Board. These will typically be asset class consultants (e.g., real estate, private equity, hedge funds, etc) that may operate on a discretionary or non-discretionary basis, as directed by the Board, to meet the objectives of the Investment Program. Where a Specialty Consultant is engaged for Private Markets, that consultant shall provide additional specialized analysis, advice, and support for the Private Markets Portfolio, consistent with the responsibilities described below. The Board may assign these responsibilities to a separate Specialty Consultant or to the General Investment Consultant. Where the General Investment Consultant is assigned these responsibilities, the Consultant shall serve in both capacities.

For Private Markets, the responsibilities of the Specialty Consultant include:

- Analyzing the asset allocation of the Private Markets Portfolio by type, implementation vehicle, geography, industry, and vintage year, and making recommendations for reallocation of assets as appropriate
- Developing and maintaining the Private Markets Annual Investment Plan in accordance with Directive #2.
- Developing a search strategy for qualified Private Markets investments and maintaining a robust database containing information on Investment Managers
- Recommending qualified Private Markets fund investments to Investment Staff and/or the Board upon completion of a thorough due diligence process, and providing the required reports to Investment Staff in accordance with the applicable Investment Directives
- Conducting ongoing monitoring of the investment performance of the Private Markets Portfolio and of individual investments within the Portfolio

- Conducting ongoing due diligence of Private Markets Investment Managers; notifying StanCERA of significant developments and adverse events; and providing analysis and advice on such issues
- Conducting ongoing monitoring of Private Markets Investment Managers' compliance with (a) their respective investment guidelines as set forth in their contracts; (b) the Board-approved Private Markets investment guidelines; and (c) applicable requirements of this IPS, Investment Directives, and Procedures
- Assisting Investment Staff in contract negotiations with selected Private Markets Investment Managers
- Making recommendations for the retention or termination of Private Markets Investment Managers
- Evaluating and providing due diligence, analysis, and recommendations regarding specialized Private Markets transactions, including co-investments, secondary investments, and GP-led transactions (including continuation vehicles and similar restructurings)
- Assisting Investment Staff with the evaluation and management of end-of-life Private Markets investments and funds, including extensions, restructurings, secondary sales, and other disposition or wind-down matters
- Attending meetings as needed; and
- Performing other duties in accordance with the terms of its contract and applicable State and Federal law.

5. INVESTMENT MANAGERS

Investment Managers are delegated the responsibility of investing and managing Plan assets in accordance with all applicable laws and the terms of the investment management, limited partnership, limited liability company, and other agreements and instruments governing StanCERA's investments. Investment Managers shall also comply with all applicable provisions of the StanCERA Investment Policy Statement and StanCERA Directives, Policies and Processes/Procedures. The Board expects that Investment Managers shall agree to act as a fiduciary to the Plan consistent with prevailing legal and industry standards applicable to the manager. Each Investment Manager shall be a qualified investment professional, which may include a registered investment adviser, a bank or trust company, an insurance company, or another entity legally authorized and sufficiently qualified to manage institutional assets. Investment Managers shall generally be responsible for making all investment decisions on a discretionary basis regarding assets placed under their management and will be accountable for achieving their investment objectives. Such discretion shall include decisions to buy, hold, and sell investments in amounts and proportions reflective of the stated investment mandate.

The terms and conditions governing each Investment Manager's fiduciary obligations, investment authority, and compliance responsibilities shall be set forth in the applicable investment management agreement or fund documents. StanCERA will seek, to the extent practicable and consistent with the structure of each investment

vehicle, to ensure that the interests of Investment Managers are appropriately aligned with those of the Plan and its beneficiaries.

In addition to the obligations above, Investment Managers shall:

- Communicate promptly with Investment Staff and/or the Consultant regarding investment strategy, investment results, and any non-conforming issues that may have a significant and/or negative impact on the portfolio
- Cooperate fully with Investment Staff, the Consultant, StanCERA's custodian, and other StanCERA vendors concerning requests for information
- Submit all required reports to Investment Staff and the Consultant in accordance with their respective contract terms
- Attend Board or Staff meetings as needed, either in-person or electronically

6. CUSTODIAN BANK

The Custodian Bank, selected by the Board to act as the principal custodian of assets of the trust, is delegated the responsibility of holding the assets and evidence of interests owned by StanCERA in investment vehicles and cash (and equivalents). The Custodian Bank accepts a fiduciary duty to hold such assets separate and apart from its own assets (other than cash that is held as a deposit obligation with its banking department). The Custodian Bank also accepts fiduciary duties with respect to any Plan assets for which it maintains or exercises any discretionary authority. The Board may authorize the Custodian Bank to invest in temporary short-term fixed income investments both for the investment strategies and as a part of the cash portion of Plan assets. Such investments will be managed in general accordance with short-term fixed income investment guidelines as detailed in the Custodial Agreement. Cash managed for investment strategies shall be considered to be sub-portions of the assets managed by the directing Investment Managers.

B. **Conflicts of Interest**

The Board, Staff, Consultant(s), and other service providers shall act in the best interests of the Plan's participants and beneficiaries and shall appropriately identify, disclose, and manage actual, potential, or apparent conflicts of interest. Consultant(s) shall disclose to the Board any relationship or economic interest that could reasonably be viewed as impairing the objectivity of their advice, including advice regarding strategic asset allocation, asset class structure, or investment manager selection. Board members, Staff, Consultant(s), and other applicable parties shall comply with StanCERA's Conflict of Interest Code, Placement Agent Disclosure Policy, and applicable provisions of California law, including the Political Reform Act.

4. Investment Philosophy

The Investment Philosophy represents the foundational principles on which the Investment Program is based. Every investment decision should be made with these foundational

principles in mind to promote the fulfillment of the fiduciary obligations. The statements below set forth the Board's Investment Philosophy:

Plan objectives should guide all decision making

The Investment Program is designed to provide benefits to participants over a long term without accepting undue risks that could be detrimental to the participants or Plan sponsors. The Investment Program, therefore, must be managed in a prudent manner recognizing the relationships between the benefits promised to participants and their beneficiaries, the financial health of the Plan sponsors, and the exposures within the Investment Program.

Asset allocation drives portfolio volatility and returns

It is impossible to accurately and consistently predict the future; therefore, the Plan is required to be prudently diversified across and within asset classes in anticipation of various economic conditions. In a well-diversified portfolio, the overall volatility of investment returns is principally driven by the asset allocation and secondarily driven by the individual investment strategies. As such, asset allocation is the primary tool by which the Board can manage the expected risk/return profile of the Plan.

Short-term investing

Over shorter investment periods, volatility can be more detrimental to the success of the Investment Program. Because paying benefits to participants and their beneficiaries occurs continuously, the forced selling of assets during broad market corrections to meet these payments could result in the long-term impairment of investable capital. By maintaining a portion of the portfolio invested in low-volatility, highly liquid securities and investment strategies, the Investment Program will be able to mitigate or avoid the forced selling of assets during broad market corrections.

Long-term investing

Over longer investment periods, such as a full market cycle which could be 5+ years or longer, volatility can be managed more effectively to produce beneficial results for the Investment Program. Market corrections will occur and when they do, patient and well-capitalized investors are able to wait until the market recovery takes place. Additionally, broad market corrections have historically provided investment opportunities for those with available capital and the foresight to make additional investments.

Fees

Fees directly impact the investment results of the Investment Program but are necessary to appropriately compensate the investment management of the Investment Program. Fees must, therefore, be measured closely against the value the Investment Program expects to earn and aligned to ensure incentives are consistent with the objectives of the Plan.

5. Investment Objectives

The investment objectives of the Investment Program are:

- To provide liquidity to meet retiree benefit payments in a timely manner;
- To produce long-term growth to meet future retiree benefit payments and, if applicable, to close a funding gap over time; and
- To protect the assets against the adverse impacts of rising inflation and investment market volatility.

Investment objectives specific to the individual investment strategies are further defined in the Board's Investment Strategy portion of this IPS.

6. Investment Strategy

The Board has chosen to employ an investment strategy that seeks to align the Investment Program with the investment objectives listed in Section 5 of this IPS. The strategy divides the portfolio into three functional sub-portfolios—Liquidity, Growth, and Diversifying—to address each investment objective highlighted in Section 5. The Liquidity Sub-portfolio is dedicated to funding near-term benefit payments. It is joined with the longer-term Growth Sub-portfolio as well as the Diversifying Sub-portfolio, which is intended to offset some of the investment risks embedded in the Growth Sub-portfolio. While the three sub-portfolios are aligned with the investment objectives individually, collectively they allow the Investment Program to provide appropriate risk and return characteristics.

A. Asset Allocation

The Board has adopted a strategic asset allocation based on the Plan's projected actuarial liabilities, liquidity needs, risk tolerance and the risk/return expectations for various asset classes. This asset allocation seeks to optimize long-term returns for the level of risk the Board considers appropriate. The current asset allocation table may be found in Directive #1.

Since projected liability and risk/return expectations will change over time, the Board will conduct a periodic review of the strategic asset allocation to maintain an expected optimal allocation. The Board may also revise the asset allocation in response to significantly changing conditions that have affected valuations and forward-looking expected returns of asset classes. The Board will review capital market expectations annually. The result of this review will be used to update the Investment Directives as needed.

B. Functional Sub-portfolios

As noted previously, the investment strategy for the Investment Program employs three functional sub-portfolios to construct the comprehensive asset allocation. The allocation to the Liquidity Sub-portfolio is assessed annually and is based on the projected benefit payments and expenses of the Plan. The remaining assets are invested in the Growth and Diversifying sub-portfolios. Annually the Board shall review the relative size and composition of these sub-portfolios and revise them as necessary through Investment Directives. The functional sub-portfolios are set forth below:

1. LIQUIDITY SUB-PORTFOLIO

The purpose of the Liquidity Sub-portfolio is to ensure adequate assets are available to pay benefits over an extended timeframe as outlined in the Investment Directives. The Board will establish a target allocation amount of a specific number of months of the difference between contributions and benefit payments plus expenses ("shortfall") in the Liquidity Sub-portfolio. The assets will be invested in highly liquid, low volatility securities expected to generate modest levels of return while preserving capital throughout a market cycle. This portfolio will contain assets such as cash, short-term bonds, laddered government bonds, and other investments that provide fixed, contractual cash flows with a minimum level of credit risk. As a secondary purpose, a portion of the Liquidity Sub-portfolio may be allocated to the Growth Sub-portfolio during broad market corrections so long as at least 48 months of projected shortfall is maintained in the Liquidity Sub-portfolio.

The success of the Liquidity Sub-portfolio will be measured by its ability to directly fund each year's annual benefit payments without having to draw from other sources of capital or add any unfunded liabilities to the System to meet this obligation. It will accomplish this objective through low-risk, cash flowing investments, as well as providing a stable offset to the rest of the portfolio during periods of severe market stress.

2. GROWTH SUB-PORTFOLIO

The purpose of the Growth Sub-portfolio is to grow invested assets over the long term in order to pay future benefits. Assets from the Growth Sub-portfolio may be sold over time and transferred to the Liquidity Sub-portfolio as needed. This portfolio is characterized by a long investment horizon and can, therefore, accept a higher level of volatility. Assets in this portfolio may be volatile, have reduced liquidity, and derive the bulk of their return from capital appreciation. These assets include public and private equity, corporate and other debt with credit risk premiums, private real estate and other private assets.

The success of this portfolio will be measured primarily by compounded annual growth rates in conjunction with the annualized standard deviation of returns as the primary measure of risk. Performance evaluation will, therefore, focus on the long-term total risk-adjusted return of the portfolio.

3. DIVERSIFYING SUB-PORTFOLIO

The purpose of the Diversifying Sub-portfolio is to offset the investment risk of the Growth Sub-portfolio. Investment strategies in the Diversifying Sub-portfolio are expected to have return profiles that have a low correlation to those in the Growth Sub-portfolio. This is expected to effectively dampen the market volatility across the entire portfolio. As a secondary objective, the investment strategies in the Diversifying Sub-portfolio will offer additional sources of return to those in the Liquidity and Growth sub-portfolios. Assets in the Diversifying Sub-portfolio may be sold

during times of market stress or when the assets in the Growth Sub-portfolio are impaired in order to fund the Liquidity Sub-portfolio.

The success of the Diversifying Sub-portfolio will be measured by its ability to offset declines in value in the Growth Sub-portfolio, as well as its ability to provide liquidity during times of market stress.

4. INTERACTION BETWEEN THE FUNCTIONAL SUB-PORTFOLIOS

The allocations to the Liquidity, Growth, and Diversifying sub-portfolios will vary over time. The Liquidity Sub-portfolio will operate as a drawdown vehicle to pay benefits and expenses. The Growth and Diversifying sub-portfolios will be subject to the volatility of the markets in which each functional sub-portfolio invests. In order to reallocate between the functional sub-portfolios, the Board will conduct two annual reviews: an annual capital markets review to assess the relative value and risks associated with each asset class; and an annual funding plan to determine how to replenish the Liquidity Sub-portfolio.

An annual review of the capital markets will be delivered to the Board by the Consultant. The Consultant will provide the Board current forward-looking risk and return assumptions for all major asset classes. In conjunction with this review, the Consultant will also provide a recommendation of how best to allocate assets within each functional sub-portfolio. If necessary, the Consultant will recommend changes in target allocations to the underlying asset classes in order to deploy the Investment Program's assets effectively in the upcoming year.

Additionally, and in coordination with the capital markets review, Staff will present an annual funding plan, which will provide a recommendation of how best to replenish the Liquidity Sub-portfolio program to maintain the required number of months of shortfall coverage. Staff will provide an annual report to the Board on the progress of funding the Liquidity Sub-portfolio through a combination of harvesting income from the Growth and Diversifying sub-portfolios, asset sales in the Growth and/or Diversifying sub-portfolios or the use of contributions. Under normal market conditions, the balance in the Liquidity Sub-portfolio is expected to vary between 60 and 108 months of projected shortfall.

C. Investment Strategy Attributes

All investment strategies, whether currently used by the Investment Program or being considered for inclusion in the Investment Program, will be evaluated on their own unique risk and return characteristics as well as their contribution to the overall Investment Program's risk and return characteristics. Other risks pertaining to the individual investment strategies and/or the firm managing the strategy will also be considered.

Fees and expenses of the investment strategies will be closely evaluated against competitive strategies and the value provided for the services rendered. While lower fees are clearly preferred over higher fees, the Plan seeks to identify investment strategies capable of providing value for participants by generating investment returns in excess of

benchmark returns plus fees. Fee structures will be evaluated to ensure appropriate incentives are provided to achieve the desired outcomes for the Investment Program.

D. Rebalancing

The Board recognizes there may be a cost to maintaining strict adherence to a target asset allocation in terms of both transaction costs and opportunity costs. The Board also recognizes that the benefit of cost minimization must be balanced against the assumption of active risk associated with allowing variances to asset allocation targets.

Portfolio rebalancing shall be conducted in order to meet two distinct objectives. The first objective is to maintain the long-term strategic asset allocation targets approved by the Board. The second is to capture valuation-based opportunities by deviating from the long-term strategic asset allocation targets as deemed appropriate by the Board.

In order to maintain the Board-approved strategic asset allocation, Investment Staff, in consultation with the General Investment Consultant, shall be authorized to develop and implement rebalancing transactions to address deviations from the Board-approved strategic asset allocation targets. Any such rebalancing shall be undertaken to reduce deviations from the Board-approved strategic asset allocation. Any such rebalancing actions require approval by the Executive Director prior to execution and shall be reported to the Board at either its next meeting or at a meeting in advance of execution.

Special consideration will be given to illiquid asset classes recognizing that the funding and redemption processes are different than those of the liquid asset classes. As such, each illiquid asset class may be assigned a specific liquid asset class to function as a public market proxy.

E. Managing Investment Strategies

While the Board believes the vast majority of investment return over the long term is dependent on the asset allocation decision, it recognizes additional risk and return may be generated by how the asset allocation is implemented.

1. HIRING A NEW MANAGER

The Consultant shall conduct all investment due diligence activities in connection with hiring new managers. In all cases, the hiring process must be consistent with the requirements for vendor selection detailed in the Processes and other Plan policy documents (e.g., Procurement Policy, Placement Agent Disclosure Policy, Conflict of Interest Code). The Executive Director shall have authority to execute the contracts consistent with the Processes.

Quiet period. During the process of hiring a new manager, a "quiet period" will apply during the evaluation process, during which time no Board member may knowingly have any communication with any actual or potential candidate for the mandate, unless authorized by the Board in connection with the due diligence process in selecting managers. The quiet period shall cease upon the Board's entering into a contract for the Investment Manager(s) selected for the mandate. The Consultant is

responsible for alerting the candidates to the quiet period and its restrictions. A violation of the quiet period rule may result in disqualification of the candidate or other appropriate Board action.

2. TERMINATING EXISTING MANAGERS

Terminating investment strategies is an inherently subjective process that incorporates quantitative performance data, qualitative characteristics, and the overall fit of the strategy within the investment program. Because behavioral biases can influence both individual and collective decision-making, it is important that the Board apply a consistent and disciplined evaluation framework when assessing any strategy for potential termination. This IPS section is intended to provide clarity for the Board, Staff, and outside professionals involved in the process, and does not apply to portfolio rebalancing driven by asset allocation decisions.

Ongoing evaluation of investment strategies occurs through quarterly performance reviews, during which each strategy is measured against its appropriate benchmark and peer universe. These reviews assess whether key performance drivers align with the stated investment strategy, and flag any meaningful deviations. Organizational developments — including changes to personnel, investment philosophy or process, regulatory examinations, and significant declines in assets under management — are also monitored. Periodic reviews conducted directly with investment managers supplement this process and provide additional insight into a firm's ability to effectively execute its strategy over time.

The policy adopts a generalized approach to investment strategy and investment manager evaluation along the following 6 criteria:

- People and organizational stability;
- Investment philosophy;
- Investment process;
- Pricing against the competitive and passive universes for similar strategies;
- Investment performance on absolute, relative, and risk-adjusted bases; and
- Regulatory considerations.

This list is intended to provide a framework for investment strategy evaluation, but it is not all-inclusive and other considerations may be incorporated

Absent emergency circumstances (described below), prior to terminating a manager, the Consultant and/or Staff shall present a detailed termination memo to the Board that includes:

- Purpose of the mandate
- Reason(s) for termination
- Specific plan to replace or temporarily invest the assets

Emergency termination. An "emergency" will be deemed to exist when an investment strategy suffers the resignation or other loss of an investment manager and no appropriate replacement is available; when an investment manager dissolves, ceases to exist, or is otherwise incapable of carrying out its activities in the ordinary course of its business; when an investment manager is actually or effectively "shut down" by a regulatory agency of a state or the Federal government or is accused of theft or fraud by a regulatory agency or other government body; when the Plan's investment is in jeopardy of material loss; or when such other developments with the investment manager give concern to the Consultant or Investment Staff that the investment is no longer prudent for the Program. Action to transfer management of the affected investment strategy shall be taken as soon as possible after StanCERA learns of the emergency. In the case of an emergency, Investment Staff will attempt to notify the Chair and Vice Chair of the Board immediately; notify the Custodian Bank that the Investment Manager's Managed Account is to be frozen and, except for those trades which are pending, no further trading is authorized; and may call an emergency meeting of the Board to take further action.

7. Risk Philosophy

The Board recognizes that the assumption of investment risk is necessary to meet the Plan's objectives. Investment risk is viewed as both the annualized standard deviation of investment returns (volatility) and drawdown exposure. Drawdown exposure measures the expected investment loss during a market correction. Additional sources of risk include regulatory, governmental, counterparty, environmental, social and currency, among others. Investment risk, in and of itself, is neither intrinsically good nor bad; it is a condition accepted in the pursuit of investment returns. The goal in managing investment risk is to ensure that an acceptable level of risk is being taken at the total Plan portfolio level. To accomplish this goal, the Plan invests in broad asset classes, via specific investment strategies within those asset classes, which have desirable expected return, risk, and correlation characteristics. While the individual strategies have a wide range of risk and return characteristics, the correlations between the strategies allow for effective portfolio diversification.

The approach used in constructing the portfolio further focuses on the risk characteristics by ensuring the preservation of the Liquidity Sub-portfolio assets as detailed previously in this IPS. Because these assets are invested in lower risk and lower return investments, the assets are well protected. This then allows for the Growth Sub-portfolio to assume greater investment risk in pursuit of higher expected returns. The Diversifying Sub-portfolio then offsets a portion of the investment risk embedded in the Growth Sub-portfolio to protect against drawdown risks.

8. Portfolio Monitoring

Delegation of investment functions by the Board requires proper oversight. Reporting processes are, therefore, designed to provide the Board with this oversight. Accurate, timely, and clear reporting to the Board of the Plan's assets, investment returns and risks, portfolio

costs, and investment decisions are essential to assisting the Board in discharging its fiduciary duties.

Performance of managers, asset classes, sub-portfolios, and the total Fund is best evaluated versus appropriate benchmarks or peer groups over at least one full market cycle, generally a period of at least 5 years. Shorter-term performance and manager/market changes should also be considered consistent with the evaluation framework described in Section 6.E (Managing Investment Strategies), and early action may be taken when it is in the best interest of the Plan

As part of the portfolio monitoring process, StanCERA will perform investment manager due diligence. The guidelines for these visits are outlined in Directive #4.

Policy Review

The Board shall review this policy at least annually and amend it as appropriate.

9. History of Policy Revisions

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