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Effective Date: 10/1/2019
I. INTRODUCTION AND PURPOSE

This Non-Traditional Investments Policy (“Policy”) is an organizational-level document that sets overall direction in guiding the System in fulfilling its fiduciary obligations as it relates to Non-Traditional Investments portfolios (Private Markets, High Yield / Private Credit, Private Real Estate and Private Infrastructure) and Non-Traditional Investment structures within other portfolios (Absolute Return and Commodities as of the adoption of this policy). The Policy is intended to provide parameters to ensure prudence and care in execution of the Non-Traditional Investment portfolios. The implementation of this policy is outlined in the procedure manuals for Non-Traditional Investments as maintained by the Non-Traditional Investment Office Professionals. The Board, as the ultimate governing fiduciary, sets and adopts investment policies and monitors compliance with those policies as well as progress made toward stated goals.

II. ROLES AND RESPONSIBILITIES

Roles and Responsibilities for Investment Office Professionals (IOP) are identified within PSERS' Investment Policy Statement (IPS).

III. STRATEGIC OBJECTIVES

Non-Traditional Investments portfolios seek to outperform their respective performance benchmarks over long-term time horizons through prudent investment commitment pacing, diversification, and external manager selection.

The Board approves Non-Traditional Investments portfolios as part of the Strategic Asset Allocation (SAA) to:

- Increase the diversification of the System's assets by providing exposure to private investments as part of the overall investable universe
- Take advantage of the ability to accept limited liquidity in exchange for an anticipated return premium

IV. PERFORMANCE OBJECTIVES

The long-term performance objective for each portfolio is to generate net-of-fee returns, consistent with the risk assessment of the investment, that exceed the applicable policy benchmark as set forth in the IPS.
V. RISK MANAGEMENT

Non-Traditional Investments do not easily lend themselves to traditional quantitative measures of risk, such as standard deviation and benchmark tracking error. Rather, risk is managed through a combination of quantitative and qualitative techniques. PSERS seeks to identify and acknowledge the sources and types of risk inherent in each underlying investment strategy during the underwriting (due diligence) process. The key components of the process are identified below:

- **Sourcing and Identification:** IOP identify potential managers through a multitude of sources including external consultants and peer institutions.

- **Manager Interviews: Meetings, Calls and Negotiation of Terms**
  - Thoughtful structured interviews allow the Portfolio Manager to project anticipated manager’s ex-ante performance by understanding the decision makers, their philosophies, organizational structures and motivations, and the resultant impact on performance.
  - Fees and other pertinent terms negotiated. Non-Traditional Investments may have substantial fees and costs; consequently, emphasis will be placed on negotiating, monitoring and controlling the direct and indirect costs of each investment.

- **Performance Analysis**
  - IOP analyze historical results to prove the merits of a manager’s investment strategy and the execution thereof. A manager’s relative performance is assessed against relevant metrics, including peer quartile rankings and public market equivalent returns (PME).

- **Document Review:** Items to be reviewed fall into the following categories:
  - Current Due Diligence Questionnaires and Presentation Materials
  - Historical Client Letters and Communications
  - Audited Financial Statements
  - Offering Materials (e.g. Private Placement Memorandum, Limited Partnership Agreement, Subscription Document)
  - External Consultant(s) memorandum

- **Public Information Review**
  - IOP, in conjunction with the specialty consultant, gather and review information that is publicly available, including Form ADV, about the manager and key individuals at the firm.

- **Reference Calls**
  - IOP performs reference calls.

- **Operations Review and Due Diligence**
  - The specialty consultant conducts a full operational review and issues an Operational Due Diligence (ODD) memorandum.
  - IOP reviews the completed ODD memorandum.

- **Memorandums of Recommendation**
  - IOP and the relevant specialty consultant each prepare memorandums of recommendation that address key aspects of the investment, generally including, firm overview, market opportunity, portfolio fit, track record, and identified risks.
Allocation Implementation Committee (AIC) Review and Approval
- The AIC, an internal Investment Office committee, reviews the IOP and specialty consultant memorandums and supporting information. The AIC then votes on whether to recommend the investment to the Board.

Preliminary Legal/Side Letter Negotiation
- IOP provides legal documents to PSERS’ Office of Chief Counsel (OCC) and Investment Operations groups.

Board Approval
- The IOP and specialty consultant recommendation memorandums are generally provided to the Board two weeks in advance of the Board meeting.

Contracting/Legal Negotiations
- Upon Board approval, the IOP coordinate final legal reviews with the OCC and Investment Operations groups. Identified matters will be addressed via a side letter when necessary. The side letter, unless otherwise approved by the Board, will detail PSERS-specific requirements, including but not limited to: compliance with PSERS’ placement agent policy, information collection requirements (e.g. ILPA or comparable template), disclosure of Pennsylvania political contributions, and a Limited Partners Advisory Board seat where applicable.
- Once the contracts have been approved and executed by the OCC, IOP, and PSERS’ Executive Office, the contracts are sent, if necessary, to the Office of Attorney General for review and execution.

In addition to the due diligence process outlined above, the following sections identify certain significant risks of Non-Traditional Investments and their methods of control.

- **Liquidity Risk**
Non-Traditional Investments typically have a holding period in excess of seven years, with early divestment, when feasible, being time consuming to complete and possibly resulting in a sale at a significant discount to fair market value. Therefore, these investments are deemed to be illiquid. PSERS’ overall liquidity risk is managed by the Board during the annual SAA process. Liquidity risk at the respective portfolio-level is managed via the annual pacing plan, which includes anticipated contributions and distributions from existing investments, and attempts to achieve the target exposure to each portfolio.

- **Vintage Risk**
Vintage risk refers to the temporal variance of Non-Traditional Investment performance over time. Irregular annual commitments should be minimized as it may lead to the concentration of the Non-Traditional Investment portfolio in investments made in certain years (“vintage years”). Vintage risk at the respective portfolio-level is managed via the annual pacing plan, which includes anticipated contributions and distributions from existing investments, and attempts to achieve the target exposure to each portfolio.
• **External Manager Exposure**
  External manager exposure risk typically manifests within Non-Traditional Investment portfolios in two ways: (1) the size of PSERS’ commitment to a specific partnership or fund investment; and (2) within a specific Non-Traditional Investment portfolio, that portfolio's exposure to any one external manager or firm.

  Partnership or fund investment exposure is controlled by limiting the commitment size to a specific investment partnership. The maximum commitment to a partnership is limited to the lesser of 30% of an expected fund-raise, or $500 million, unless otherwise approved by the Board. These limits do not apply to a separate account or fund-of-one.

  PSERS’ maximum total exposure (defined as net asset value plus unfunded commitments) to all partnerships and other investment vehicles sponsored by a particular external manager or firm, within a given Non-Traditional Investment portfolio, is limited to 20% of such portfolio, unless otherwise approved by the Board.

• **Geographic and Sector Concentration**
  Overconcentration to any particular geography or sector can expose the portfolio to unintended macro-level risks. As such, IOP strives to diversify Non-Traditional Investment portfolios across geographies and sectors. Geographic and sector concentration risk are considered during the due diligence process.

• **Currency Risk**
  The Non-Traditional Investment portfolios may contain exposure to investments denominated in foreign currencies as a result of its global investment mandate. Significant movements in those currencies, relative to the U.S. Dollar (USD), may impact a portfolio’s reported returns, which are denominated in USD. Currency risk is often impractical to hedge at the External Manager level but can be managed by assessing currency risk at the outset of an investment, hedging programs instituted by the External Manager at the holdings level, and/or through PSERS’ currency overlay program.

• **Leverage Risk**
  Managers in the Non-Traditional Investment portfolio may finance a portion of their asset purchases with debt. The use of debt to finance asset purchases has the potential to enhance the asset’s return on equity but also increases debt servicing costs. Higher leverage results in higher debt service costs which may increase the probability of default. The System seeks to invest with external managers that have demonstrated the prudent use of leverage. Leverage constraints are typically identified in the governing documents at the underlying investment level.

Certain PSERS practices serve to further mitigate risks across the Non-Traditional portfolios. PSERS will only consider investment structures that provide limited
liability to the System, which limits the System’s losses to the amount invested. Additionally, no single individual shall have the authority to allocate capital on behalf of the Fund and all decisions to invest require unanimous approval of the AIC, a positive recommendation from the External Consultant(s), and Board approval where applicable.

VI. MONITORING AND REPORTING

The CIO has the authority to interpret this Policy to meet individual portfolio needs. All interpretations of material policy issues and dollar amounts will be reported to the Board at the next regularly scheduled meeting. In addition, the Board receives regular updates on the portfolios as required within the IPS. The Board will review the Policy from time to time to determine if changes are necessary or desirable.

Exceptions to the Policy
From time to time, exceptions to this Policy may be required. In the event that an exception is required, the following procedures shall be followed:

- Non-urgent\(^1\) matters requiring an exception to this Policy will be addressed at the next scheduled PSERS Board meeting. The Board shall be provided a detailed written summary and rationale warranting a potential exception to the Policy. Exceptions will only be granted with Board approval (vote, motion, etc.).

- For urgent matters\(^2\) (time-sensitive) requiring an exception to this Policy, the CIO will notify the Board, in writing or via electronic mail, as soon as practicable of the matter requiring the need for an exception to the Policy. A documented notational ballot or special meeting requesting the exception will be made, and if approved, the Board will ratify the decision at the next scheduled board meeting.

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\(^1\) Non-Urgent matters are defined as those not requiring an affirmative decision prior to the next scheduled PSERS board meeting.

\(^2\) Urgent matters are defined as those requiring an affirmative decision prior to the next scheduled PSERS board meeting.