

**MINUTES of SERS Board Regular Meeting - Wednesday, December 7, 2016**

**CALLED TO ORDER: 9:30 a.m. by Chairman David R. Fillman**

**ATTENDEES:**

**Members and Designees**

David R. Fillman - Chairman  
Stephen S. Aichele  
Glenn E. Becker  
Robert W. Godshall  
Charles T. McIlhinney, Jr.  
T. Terrance Reese  
Mary A. Soderberg  
Christopher Craig – Designee for Treasurer Timothy A. Reese  
Charles Duncan – Designee for Senator Vincent J. Hughes  
Dan Ocko – Designee for Representative Dan B. Frankel  
Monica Riddle – Designee for Senator Charles T. McIlhinney, Jr.  
Ned Smith – Designee for Representative Robert W. Godshall

**Consultants**

Michael Elio, StepStone Group, LP  
Anthony Johnson, RVK, Inc.  
Rob Kochis, The Townsend Group  
Robert Palmeri, RVK, Inc.  
Ed Rataj, CBIZ  
Matt Roche, StepStone Group, LP  
Ryan Skubic, The Townsend Group  
Jim Voytko, RVK, Inc.

**Executive Staff**

David E. Durbin  
Anthony Faiola  
Christopher Houston  
Bryan Lewis

**Staff**

Rose Agnew  
Jakki Altice  
Karen Damiano-Stahler  
Patricia Dence  
Linda Engle  
Brittany Erney  
David Felix  
Pamela Hile  
Meredith Jones

Barbara Kiral  
Cheryl Krchnar  
Karen Lynn  
N. Joseph Marcucci  
Sara McSurdy  
Matthew Meads  
Jeffrey Meyer  
Jeffrey Mozdziok  
James Nolan  
Jay Pagni  
Joseph Torta  
William Truong

**Visitors**

Nicholas Allen, Lord, Abbett & Co., LLC  
Jim Kane, Unite Here  
Sandy Leopold, PA Department of Treasury  
Lisa Reber, PA Department of the Auditor General  
Kate Rinaldi, Voya Financial  
Nakeya Smith, PA Department of the Auditor General

**Presenters**

Eleanor Chambers, TDR Capital IV, L.P.  
Manjit Dale, TDR Capital IV, L.P.

## **MINUTES of the SERS Board Regular Meeting Wednesday, December 7, 2016**

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### A. RECOGNITION FOR OUTGOING BOARD MEMBER – TREASURER TIMOTHY A. REESE

Chairman Fillman recognized Treasurer Timothy A. Reese for the service he provided to the SERS board.

#### **MOTION: 2016-61**

By motion of Chairman Fillman, the board unanimously agreed to recognize Treasurer Timothy A. Reese with a board resolution, read by Dave Durbin, a copy of which shall be filed with the minutes of the meeting (ATTACHMENT A).

Designee Christopher Craig read a letter on behalf of Treasurer Reese (ATTACHMENT B).

### B. THIRD ANNUAL PA INSTITUTIONAL INVESTOR FORUM

Chairman Fillman and Mr. Aichele noted that they attended the Third Annual PA Institutional Investor Forum on behalf of the SERS board and indicated the information presented was useful in their roles on the SERS board.

### C. Investment Presentations and Reviews: SERS INVESTMENT OFFICE AND RVK, INC.

Presentation: 1. Capital Market Report

Messrs. Johnson and Voytko presented the report provided to the board (12/7/2016 board handouts).

Presentation: 2. SERS Quarterly Performance Report (as of September 30, 2016)

Messrs. Johnson and Voytko presented the report provided to the board (12/7/2016 Board Package, Investment Report, Tab 10).

Presentation: 3. Public Markets Overview Discussion

Messrs. Nolan, Truong, Johnson, and Voytko presented the report provided to the board (12/7/2016 Board Package, Investment Report, Tab 2).

Action: 1. Statement of Investment Policy Update – DRAFT for review and comment

Ms. Jones and Messrs. Nolan, Truong, Johnson, and Voytko presented the report provided to the board (12/7/2016 Board Package, Investment Report, Tabs 3, 4, 5, and 6).

#### **MOTION: 2016-62**

By motion that was moved, seconded, and approved by board members, it was

**RESOLVED:** That the board adopts the proposed revisions to SERS' Statement of Investment Policy, Real Estate Statement of Investment Policy, and Private Equity Statement of Investment Policy, as set forth in ATTACHMENT C.

Action: 2. Investment Manager Monitoring Policy Update – DRAFT for review and comment

Ms. Jones and Messrs. Nolan, Truong, Johnson, and Voytko presented the report provided to the board (12/7/2016 Board Package, Investment Report, Tab 7).

**MOTION: 2016-63**

By motion that was moved, seconded, and approved by board members, it was

**RESOLVED:** That the board adopts the proposed revisions to SERS' Investment Manager Monitoring Policy, as set forth in ATTACHMENT D.

**D. Investment Presentations and Reviews: SERS INVESTMENT OFFICE AND STEPSTONE GROUP, LP**

Presentation: 1. Private Equity Semi-Annual Performance Report (as of June 30, 2016)  
Messrs. Felix and Elio presented the report provided to the board (12/7/2016 Board Package, Investment Report, Tab 13).

Action: 1. Private Equity Interview: TDR Capital IV, L.P.

Ms. Chambers and Messrs. Felix, Elio, and Dale presented the report provided to the board (12/7/2016 Board Package, Investment Report, Tab 14).

**MOTION: 2016-64**

By motion that was moved, seconded, and approved by board members, it was

**RESOLVED:** That the board commits up to €93 million Euros (approximately \$100 million USD), plus investment expenses and pro rata share of partnership operating expenses, consistent with executed partnership documents, to TDR Capital IV, L.P., as an investment within the Private Equity asset class, subject to successful completion of contract negotiations and execution and delivery of closing documents by all parties, including required Commonwealth legal approvals, within 12 months.

**E. EXECUTIVE SESSION**

Presentation: 1. Agenda

At 12:05 p.m., the board recessed and entered executive session to receive legal advice and confidential performance information on executive session agenda items, as attached (ATTACHMENT E).

**F. LUNCH BREAK****G. PUBLIC MEETING RESUMES**

The public meeting resumed at 2:10 p.m.

**H. Investment Presentations and Reviews: SERS INVESTMENT OFFICE AND THE TOWNSEND GROUP**

Action 1: The following motions were presented as a result of discussions in executive session.

**MOTION: 2016-65**

By motion that was moved, seconded, and approved by board members, except for Mr. Aichele who recused himself because of his law firm's occasional representation of Lowe Enterprises, it was

**RESOLVED:** That the board amends the contracts of the following separate account managers within the Real Estate portfolio to update the Investment Manager Guidelines as referenced in Exhibit B of each contract:

- Heitman Capital Management, LLC
- LaSalle Investment Management, Inc.
- Lowe Enterprises Investment Management, LLC; and
- Lowe Enterprises Investment Management, LLC – GTO Account

**MOTION: 2016-66**

By motion that was moved, seconded, and approved by board members, it was

**RESOLVED:** That the board orders to (1) change the investment mandate of CBRE Clarion Securities from a global investment mandate to a domestic investment mandate; and (2) liquidate approximately \$60 million as soon as practicably possible from the CBRE Clarion Securities Account.

**MOTION: 2016-67**

By motion that was moved, seconded, and approved by board members, it was

**RESOLVED:** That the board orders to change the REIT sub-asset benchmark within the Real Estate program to the FTSE NAREIT U.S. Real Estate Index to align the benchmark with the updated mandate of a domestic REIT program.

Presentation: 1. Real Estate Semi-Annual Performance Report (as of June 30, 2016)  
Messrs. Meyer and Kochis presented the report provided to the board (12/7/2016 Board Package, Investment Report, Tab 12).

**I. SERS U.S. AND INTERNATIONAL PROXY VOTING POLICY UPDATE**

Action: 1. DRAFT for review and comment

Ms. Jones presented the report provided to the board (12/7/2016 Board Package, Investment Report, Tabs 8 and 9).

**MOTION: 2016-68**

By motion that was moved, seconded, and approved by board members, it was

**RESOLVED:** That the board adopts the proposed revisions to the SERS U.S. and International Proxy Voting Policy, as set forth in ATTACHMENT F.

**J. SERS Deferred Compensation Program (DCP) Presentations and Reviews: SERS INVESTMENT OFFICE AND RVK, INC.**

Presentation: 1. DCP Quarterly Investment Performance Analysis (as of September 30, 2016)  
Messrs. Nolan and Palmeri presented the report provided to the board (12/7/2016 Board Package, Investment Report, Tab 11).

**K. NON-DISCRETIONARY REAL ESTATE INVESTMENT CONSULTING SERVICES**

Presentation: 1. Mr. Durbin noted that a subcommittee has been formed to search for a Real Estate consultant. The subcommittee consists of Rep. Godshall, Mr. Aichele, and Chairman Fillman.

**L. STANDARD MOTIONS**

Action: 1. Minutes of Board Meeting – October 26, 2016

Chairman Fillman presented the minutes provided to the board (12/7/2016 Board Package, Administrative Report, Tab 2).

**MOTION: 2016-69**

By motion that was moved, seconded, and approved by board members, it was

**RESOLVED:** That the board approves the minutes of the October 26, 2016, board meeting.

Action: 2. Statement of Changes in Fiduciary Net Position for Period Ending – September 30, 2016

Chairman Fillman presented the report provided to the board (12/7/2016 Board Package, Administrative Report, Tab 3).

**MOTION: 2016-70**

By motion that was moved, seconded, and approved by board members, it was

**RESOLVED:** That the board accepts the State Employees' Retirement System's Statement of Changes in Fiduciary Net Position for the period ending September 30, 2016.

**M. PERSONNEL COMMITTEE RECOMMENDATION**

Action: 1. This discussion was tabled.

**N. REPORT FROM CHIEF FINANCIAL OFFICER**

Presentation: 1. DCP

Mr. Faiola noted that the report was provided to the board (12/7/2016 Board Package, Administrative Report, Tab 10).

**O. REPORT FROM EXECUTIVE DIRECTOR**

Action: 1. SERS 2017-2019 Strategic Business Plan

Mr. Durbin noted the following motion was presented as a result of discussions in executive session.

**MOTION: 2016-71**

By motion that was moved, seconded, and approved by board members, it was

**RESOLVED:** That the board adopts the State Employees' Retirement System Strategic Business Plan for the period 2017-2019, which, in furtherance of recommendations contained in the Funston Advisory Final Report, establishes the agency's strategic goals and plan for operational and investment direction.

Presentation: 1. Board Order

Mr. Durbin provided the board with the following information on the results of the notational ballot regarding Board Adjudication.

**Account of Thomas R. Czarnecki**

**Docket No. 2007-08**

**Claim of Thomas R. Czarnecki**

The State Employees' Retirement Board issued an Order directing the State Employees' Retirement System to investigate Claimant's account, work and compensation history, and other relevant factors and to adjust Claimant's and his employer's contributions, service credit, compensation, and benefits in accordance with 71 Pa. C.S. §5954.

Presentation: 2. Legislative Update

Mr. Durbin noted that the report was provided to the board (12/7/2016 Board Package, Administrative Report, Tab 8).

P. NEXT BOARD MEETING – JANUARY 25, 2017

Chairman Fillman noted that the next regular meeting of the SERS board is scheduled for January 25, 2017.

Q. TREASURY CONSULTANT RETIREMENT

Designee Christopher Craig noted the retirement of Treasury Consultant, Mr. Sandy Leopold, who has served the Treasurer for over seven years. Mr. Leopold responded to the acknowledgement and stated it has been a pleasure working with the staff over the years.

R. MOTION TO ADJOURN

Action: 1. Adjournment

**MOTION: 2016-72**

By motion of Chairman Fillman, the board unanimously agreed to adjourn the meeting at 3:00 p.m.

Respectfully submitted,



David E. Durbin  
Executive Director

Commonwealth of Pennsylvania  
State Employees' Retirement System



RESOLUTION

**WHEREAS**, Timothy A. Reese became a member of the State Employees' Retirement Board effective June 26, 2015, by virtue of his nomination and confirmation as State Treasurer; and

**WHEREAS**, Timothy A. Reese has provided the State Employees' Retirement Board with insight and perspective derived from his position as State Treasurer and a financial advisor; and

**WHEREAS**, Timothy A. Reese also has served the Board as a member of the Deferred Compensation Committee; now therefore be it

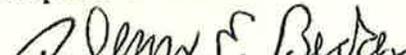
**RESOLVED**, That the Pennsylvania State Employees' Retirement Board expresses its sincere appreciation to Timothy A. Reese for his dedication to the System and its members, and wishes him the best of health, happiness and success in all future endeavors; and be it further

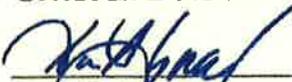
**RESOLVED**, That the original resolution be transmitted to Timothy A. Reese, and a copy included in the minutes.

December 7, 2016  
Harrisburg, Pennsylvania

  
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David R. Fillman, Chairman

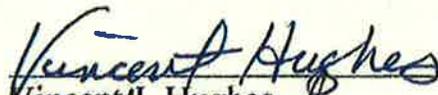
  
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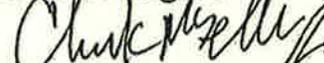
  
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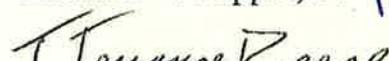
  
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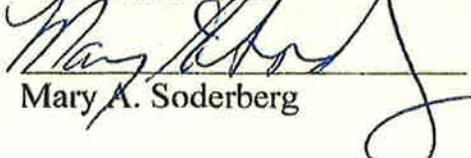


  
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Charles T. McIlhinney, Jr.

  
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Michael V. Puppio, Jr.

  
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T. Terrance Reese

  
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Mary A. Soderberg



TREASURY DEPARTMENT  
COMMONWEALTH OF PENNSYLVANIA  
HARRISBURG, PA 17120

TIMOTHY A. REESE  
THE STATE TREASURER

December 7, 2016

Mr. David E. Durbin, Sr.  
Executive Director  
Commonwealth of Pennsylvania  
State Employees' Retirement System  
30 North 3<sup>rd</sup> Street, Suite 150  
Harrisburg, Pennsylvania 17101-1716

Dear Mr. Durbin:

It has been a pleasure and a privilege to serve on the Pennsylvania State Employees' Retirement System Board. Your leadership, wisdom and commitment have been invaluable to myself and all the board members.

I want to sincerely thank you, staff, and fellow board members for your dedication and professionalism. I have truly enjoyed our working relationship.

Yours with appreciation,

A handwritten signature in black ink that reads "Timothy A. Reese".

Timothy A. Reese  
State Treasurer



**pennsylvania**  
STATE EMPLOYEES' RETIREMENT SYSTEM

**Commonwealth of Pennsylvania  
State Employees' Retirement Board  
Statement of Investment Policy**

**Adopted April 21, 2004  
Amended December 7, 2016**

## Table of Contents

1.	Introduction .....	1
2.	Statement of Purpose of Investment Policy .....	1
3.	Prudent Investor Standard .....	1
4.	Fiduciary Status, Duties, and Responsibilities of Board, Staff, Investment Managers, Other Agents, and State Treasurer .....	2
	A. Board of Trustees .....	2
	B. State Employees’ Retirement Board Staff .....	3
	C. Internal Audit .....	4
	D. Investment Managers .....	5
	E. General Investment Consultant .....	6
	F. Private Equity Consultant .....	6
	G. Real Estate Consultant .....	6
	H. Portfolio Evaluation Advisor .....	7
	I. State Treasurer .....	7
	J. Actuarial Consultant .....	7
5.	Investment Objectives .....	7
	A. Rebalancing Policy .....	8
6.	Investment Guidelines .....	8
7.	Prohibited Transactions .....	9
8.	Investment Manager Evaluations .....	9
9.	Corporate Governance Standards .....	9
	A. Proxy Voting Procedures .....	10
	B. Corporate Actions .....	10
10.	Trading and Brokerage Practices .....	11
11.	Public Access to Records .....	11
12.	Procedures for Amending this Policy Statement .....	11
13.	Separate Documents Related to this Policy Statement .....	12
14.	Glossary of Terms .....	13
15.	Appendix .....	14

**Commonwealth of Pennsylvania  
State Employees' Retirement Board  
Statement of Investment Policy**

**1. Introduction**

The State Employees' Retirement Fund ("Fund") was established in 1923 by an act of the Pennsylvania legislature. The purpose of the Fund is the accumulation of funds exclusively for the benefit of the members and beneficiaries of members of the State Employees' Retirement System ("SERS" or the "System") for the payment of withdrawal, retirement, disability, and death benefits as provided in Pennsylvania Consolidated Statutes Title 71, Part XXV ("Retirement for State Employees and Officers"). The Fund is under the exclusive control and management of an eleven member Board of Trustees ("Board"). Six members are appointed by the Governor and confirmed by the State Senate to four-year terms. Two members of the Senate are appointed by the President Pro Tempore of the Senate, and two members of the House by the Speaker of the House, and serve on the Board for the duration of the terms for which they were elected. The State Treasurer serves as a member of the Board, ex-officio.

The Statement of Investment Policy (the "Policy") was originally adopted by the Board on September 19, 1979 and was last revised by Board action on January 27, 2016.

**2. Statement of Purpose of Investment Policy**

This document specifically outlines the investment philosophy and practices of SERS and has been developed to serve as the governing policy for the management of the System's assets. The purpose of this Policy is to formalize the Board's investment objectives and policies, and to define the duties and responsibilities of the various individuals and entities involved in the investment process. The assets of SERS will be managed with the primary objectives of the payment of benefit obligations to participants in the plans as well as to maximize return with acceptable risk considerations and sufficient liquidity so that employer contributions can be minimized. Therefore, it is crucial that the Board adopt a long-term plan by which the assets of the System will be managed and enhanced through prudent investments. This Policy is intended to ensure that the level of assets is adequate to cover the accumulated liabilities of the System. This is an official investment policy document of SERS. Deviation from this document is not permitted without explicit written permission, in advance, from the Board.

In developing this Policy, the Board understands and accepts its fiduciary obligations to the members of the System. These obligations are legal in nature, and are outlined in Title 71, Pennsylvania Consolidated Statutes, Section 5931, a copy of which is attached hereto as Appendix I.

**3. Prudent Investor Standard**

The Board's investment authority is governed by the "prudent investor" standard as set forth in Title 71, Pennsylvania Consolidated Statutes, Section 5931(a):

**Control and management of fund.** The members of the board shall be the trustees of the fund. Regardless of any other provision of law governing the investments of funds under the control of an administrative board of the State government, the trustees shall have exclusive control and management of the said fund and full power to invest the same in accordance with the provisions of this section, subject, however, to the exercise of that degree of judgment, skill and care under the circumstances then prevailing which persons of prudence, discretion and intelligence, who are familiar with such matters, exercise in the management of their own affairs not in regard to speculation, but in regard to the permanent disposition of the funds, considering the probable income to be derived therefrom as well as the probable safety of their capital. The trustees shall

have the power to hold, purchase, sell, lend, assign, transfer or dispose of any of the securities and investments in which any of the moneys in the fund shall have been invested as well as of the proceeds of said investments, including any directed commissions which have accrued to the benefit of the fund as a consequence of the investments, and of any moneys belonging to said fund, subject in every case to meeting the standard of prudence set forth in this subsection.

No provision of this Policy shall be construed in contravention of the Board's statutory investment authority found in Title 71, Pennsylvania Consolidated Statutes, Section 5931.

#### **4. Fiduciary Status, Duties, and Responsibilities of Board, Staff, Investment Managers, Other Agents, and State Treasurer**

SERS is one of the larger public pension funds in the United States. Due to its size and investment structure, its operational requirements are complex. In order to administer the System and carry out its investment obligations, the Board relies heavily on both staff and external contractors. Because of the number of parties involved, their roles as fiduciaries must be clearly identified. Such identification increases operational efficiency, ensures clear lines of responsibility, and reduces or eliminates duplication of effort.

##### **A. Board of Trustees**

Title 71, Pennsylvania Consolidated Statutes, Section 5931(e) provides, in part, as follows:

The members of the board, employees of the board, and agents thereof shall stand in a fiduciary relationship to the members of the system regarding the investments and disbursements of any of the moneys of the fund and shall not profit either directly or indirectly with respect thereto.

In exercising this fiduciary responsibility, the members of the Board, employees of the Fund, and agents of the Fund are governed by the "prudent investor" standard and the exclusive benefit standard. The exclusive benefit standard requires these parties to act solely within the interests of the plan's participants and beneficiaries, and for the exclusive purpose of providing benefits to participants and beneficiaries.

The Board may, when possible and consistent with its fiduciary duties imposed by law, including its obligation to invest and manage the Fund for the exclusive benefit of the members of the System, consider whether an investment in any project or business enhances and promotes the general welfare of the Commonwealth and its citizens. Where investment characteristics are equivalent, the Board's policy will favor investments that will have a positive impact on the economy of Pennsylvania.

The members of the Board are responsible as trustees for the proper management of the assets of the Fund. The Board has the responsibility of establishing and maintaining broad policies and objectives for all aspects of the System's operations. Specifically with regard to investments, the Board seeks the recommendations of the staff and consultants prior to taking action. In carrying out these duties, the Board will be responsible for:

1. Reviewing and approving a biennial Investment Plan that sets forth the direction of the Fund and work plan initiatives for the coming two years. This Investment Plan shall incorporate long-term allocation ranges to the asset classes.

2. Approving the engagement and termination of investment managers. Staff and consultants will identify potential candidates. Potential managers will be evaluated based on their ability to achieve the objectives outlined in the Investment Plan and their demonstrated experience and expertise for the specific mandate. Board suggestions for potential managers who meet these criteria will be evaluated by staff and consultants. While individual Board Members may meet with prospective managers, all group meetings involving a quorum of Board Members for a presentation by prospective managers shall be through formal Board meetings or Board Committee meetings. Staff and consultants are jointly responsible for carrying out the research and initial due diligence to identify qualified candidates. Staff and consultants are also jointly responsible for performing the on-going monitoring of investment managers and funds. Lastly, all prospective investment opportunities and/or investment manager terminations which are recommended to the Board must be supported by a memo from Staff and a memo from the relevant investment consultant.
3. Approving the engagement and termination of consultants.
4. Reviewing the investment performance and risk characteristics of the Fund.
5. Reviewing and approving the Comprehensive Annual Financial Report.
6. Reviewing and approving the annual actuarial report, assumptions and funding level and, reviewing and approving an actuarial experience study that is to be conducted no less than every five years.
7. Reviewing and approving the results of an asset liability study on a periodic basis, but not less than every five years.
8. Reviewing and adopting the proxy voting guidelines.
9. Oversight and monitoring of staff including, but not limited to the hiring of the Chief Investment Officer, the Executive Director, and the Director of Internal Audit.

In discharging these responsibilities, the Board has delegated certain functions to the staff and to various contractors who provide professional services to the Board. All persons who act as agents of the Board shall adhere to the highest standards of professional integrity and honesty.

#### **B. State Employees' Retirement Board Staff**

The Executive Director is responsible for administrative matters relating to the operations of the System. The Chief Investment Officer is charged with the coordination of all investment activities and matters within the System. The Investment Office reports to the Board on emerging trends and issues of concern to public pension funds generally and to the Fund in particular. The Investment Office is responsible to the Board to review and analyze the current investment climate, and to recommend adjustments with respect to this Policy that are appropriate to take optimum advantage of new conditions and strategies as they arise in the market place. To ensure that the goals and objectives of the Board are being fulfilled, the Investment Office also reviews and analyzes the philosophies, policies, and strategies employed by the investment managers, evaluating the appropriateness of their decision-making processes and their investment styles in relation to present and projected investment horizons.

The Chief Investment Officer of the System is charged with the following responsibilities:

1. To manage, on a day-to-day basis, the portfolio, its components, and agents;
2. To authorize receipt or payment for the acquisition or disposition of investments;
3. To act as liaison on behalf of the Board with all investment-related contractors;
4. To review and analyze all investment transactions for conformity to certain applicable laws, regulations, each manager's investment strategy statement, and this Policy;
5. To review investment proposals presented by investment managers, and where appropriate, summarize and recommend the same for Board consideration;
6. To analyze and summarize for the Board pertinent information from relevant publications, discussions, meetings, and research on current investment related topics;
7. To respond to inquiries from the Board and Pennsylvania Legislature, the membership, the press, other governmental representatives, and the public concerning the investments of the Fund;
8. To institute an Annual Implementation Plan ("AIP") detailing what the Fund will be doing in the next year in order to implement the Investment Plan. The purpose of the AIP is to report to the Board the status of what was accomplished and what will be accomplished going forward.
9. To prepare the Investment Plan and perform analysis and recommendations for action to present to the Board for approval and implementation consistent with this Policy and achievement of the Board's investment objectives; and
10. To perform such other duties as may be required to implement this Policy.

### **C. Internal Audit**

The Director of Internal Audit reports functionally to the Audit Committee and administratively to the Executive Director. The internal audit department is independent of the System's operational activity and is responsible for providing objective audit and review services for the entire System, including the Investment Office. Internal audit's services emphasize the promotion of adequate and effective internal controls at a reasonable cost and result in suggested improvements that will lead to economies and efficiencies in the Systems' operations.

With the advent of the Sarbanes-Oxley Act of 2002, the Board recognized the need for, and established an Audit Committee to provide additional oversight relating to the adequacy of internal controls applicable to financial reporting. The Audit Committee will meet quarterly to discuss audit related issues. The Audit Committee, at its discretion, may meet with the Director of Internal Audit in executive session. The Audit Committee may make recommendations for changes in internal controls for consideration by the Board but shall have no policy authority.

## **D. Investment Managers**

The Board continually seeks to employ investment managers that possess superior capabilities in the management of assets of public retirement systems. The Fund has carefully documented its investment processes, including those related to hiring managers to manage the Fund's investments. Those processes are available for review on the Fund's intranet. Each manager has full discretion to carry out its investment mandate subject to the investment strategy statement contained in the investment management agreement and will be expected to conduct business on behalf of the System in accordance with the mandate for which they were retained. It is the Board's policy to limit the allocation of Fund investments such that no more than 15% of the total market value of Fund assets should be invested in any one investment product offered by an investment manager, except where management of such investments is of a passive nature (e.g., index funds). Notwithstanding any of the limitations contained in this section, no liquidation of an investment shall be required solely due to changes in market value.

Each manager's benchmark will reflect that manager's particular style or tactical role in SERS' investment process. Each benchmark will be clearly specified, measurable, and replicable. Benchmarks do not have to be published or widely recognized; they may be "customized" for a particular investment style or styles. The benchmark shall be determined in advance of funding by mutual agreement between the manager, staff, and consultant. In the event of a change in management style, agreed upon change in a manager's strategy, availability of a better benchmark construction methodology, or changes to or additions in indices, a manager's benchmark may be modified by mutual consent between the manager, staff, and consultant. Despite the foregoing, it is recognized that benchmarks in the investment industry may fail to capture the investment nuances of an investment manager, which leads to tracking error relative to the benchmark.

The Board further requires those public markets investment managers selected and working on its behalf to perform the following activities:

1. To execute investment decisions that are consistent within the scope of the approved investment guidelines expressed in the respective management agreement and other relevant documents.
2. To execute investment transactions on behalf of the Board in a manner that maximizes the investment value of each transaction from the viewpoint of the Fund, utilizing such brokers and dealers as they deem appropriate to obtain the best execution capabilities and/or valuable information with respect to the economy and the affairs of corporations at the lowest total cost to the Fund.
3. To report to the Board at least quarterly through the Investment Office, with the exact frequency and format of reporting to be determined by the Investment Office, on the composition and relative performance of the investments in their designated portfolios; the economic and investment outlook for the near and long term; significant changes in the portfolio during the preceding period; and the reasons for any significant differences between the performance of their portfolios and the appropriate market indices or metrics.
4. To make themselves available as needed for meetings with the Board, staff, or agents of the Board regarding investment matters.
5. To comply at all times with all laws, regulations, contractual investment guidelines, and reporting requirements as determined by staff.

6. To perform such additional activities as detailed in each manager's investment management agreement with SERS.

#### **E. General Investment Consultant**

The Board's general investment consultant acts as a fiduciary to the Fund, providing reports to the Board on emerging trends and issues of concern to public pension funds generally and to the Fund in particular. The general investment consultant also analyzes and makes recommendations with respect to the Board's asset allocation and investment structure, policies, the investment managers' implementation of policy and strategy, the appropriate investment horizon for the Fund given its actuarial characteristics, and provides such other research as may be required from time to time.

In addition to the general investment consultant, the Board may retain other investment consultants as required for specialized needs, such as for particular asset classes or unique investment projects. These specialty consultants will report to the Board on emerging trends and issues that are germane to their respective assignments and that are of concern to public pension funds generally and to the Fund in particular. Within the scope of their assignments, the specialty consultants will also analyze and make recommendations with respect to this Policy, the investment managers' implementation of policy and strategy, and provide such other research as may be needed from time to time.

The general and specialty consultants should be free of conflicts of interest or, where they potentially exist, make complete and total disclosure to the Board and obtain pre-clearance from the board.

#### **F. Private Equity Consultant**

The private equity consultant acts as a fiduciary to the Fund, and will provide non-discretionary private equity consulting services. The private equity consultant will assist staff in performing due diligence investigations on prospective private equity and private debt investment opportunities, assist staff with identifying and accessing investment opportunities, recommend specific private equity investments to SERS, and maintain a deal log of private equity investment opportunities. The private equity consultant will also participate in the development and refinement of private equity policies, objectives, strategies, benchmarking, risk assumptions, and asset mix appropriate for each sub-asset class; as well as perform qualitative and quantitative portfolio oversight procedures and prepare performance measurement. The private equity consultant will make presentations to the Board supporting investment recommendations as they arise, and review performance at least semi-annually.

The private equity consultant should be free of conflicts of interest or, where they potentially exist, make complete and total disclosure to the Board and obtain pre-clearance from the Board.

#### **G. Real Estate Consultant**

The real estate consultant acts as a fiduciary to the Fund, and will provide non-discretionary real estate investment consulting services. The real estate consultant will assist staff in performing due diligence investigations on prospective real estate opportunities, assist staff with identifying and accessing investment opportunities, recommend specific real estate investments to SERS, and maintain a real estate database. The real estate consultant will also

participate in the development and refinement of real estate policies, objectives and strategies, benchmarking, risk assumptions, and asset mix appropriate for each sub-asset class; as well as perform qualitative and quantitative portfolio oversight procedures and prepare performance measurement. The real estate consultant will make presentations to the Board supporting investment recommendations as they arise and review performance at least semi-annually.

The real estate consultant should be free of conflicts of interest or, where they potentially exist, make complete and total disclosure to the Board and obtain pre-clearance from the Board.

#### **H. Portfolio Evaluation Advisor**

The general investment consultant, or another third party approved by the Board as a portfolio evaluation advisor, will provide quarterly investment performance evaluation and analysis to the Board. The portfolio evaluation advisor will provide the Board with comparative performance measurements against appropriate benchmarks at the total fund, asset class, sub-asset class, and advisor levels for all asset classes (except real estate and private equity investments).

These benchmarks will be defined and presented in each quarterly performance report. They are hereby incorporated by reference.

#### **I. State Treasurer**

The State Treasurer serves as the custodian of the Fund, pursuant to Title 71, Pennsylvania Consolidated Statutes, Section 5931(c). In this capacity, the State Treasurer is responsible for the safe physical custody of investment instruments and the safe custody of any book-entry investment instruments that are held in depositories on behalf of the Commonwealth. As custodian, the State Treasurer is also responsible for preparing and delivering securities for settlement as authorized by the Board, attending to corporate actions, maintaining a book of record for these securities, facilitating an annual examination of these securities and books, and for preparing payment for securities transactions upon presentation of warrants properly signed and authorized. The State Treasurer may enter into a contract with a sub-custodian bank to assist in the execution of these responsibilities.

The State Treasurer is responsible for the temporary investment of cash balances until funds are required to meet disbursements or to acquire investments.

#### **J. Actuarial Consultant**

Pursuant to Title 71, Pennsylvania Consolidated Statutes, Section 5902(j), the Board engages an actuary to perform a valuation of the various accounts of SERS on an annual basis within six months of the close of each calendar year. In every fifth year, the Board shall have the actuary conduct an actuarial investigation and evaluation of the system based on data including the mortality, service, and compensation experience provided by the Board annually during the preceding five years concerning the members and beneficiaries.

### **5. Investment Objectives**

The State Employees' Retirement Fund is a mature pension plan. The appropriate investment horizon is intermediate to long-term (five to ten years) with due consideration of the characteristics of the Fund's liabilities and liquidity requirements.

The objectives of the Fund are to provide benefit payments to participants and beneficiaries at the lowest cost to the Commonwealth and to fund the program through a carefully planned and executed investment program.

The Fund seeks to produce the highest return on investment that is consistent with acceptable investment risks and sufficient liquidity that will permit the Fund to meet the System's benefit obligations, and secondarily, control the cost of the Fund to the taxpayers. The investment program is premised on modern portfolio theory. The Board recognizes that many asset classes and investments can have volatile performance and that the Fund may not achieve investment results over shorter time periods. However, over longer time periods, a well-constructed portfolio and mix of asset classes will provide the optimal results.

The Board, with the help of the staff and consultants, is charged with building a portfolio by carefully assessing the risk and return potential of the global capital markets, and making those investments that are institutionally investable and are reasonably expected to contribute to the Fund's long-term objectives and goals.

Consistent with achieving these objectives the Board has established the following goals relative to investment performance:

- Achieve a net total return equivalent to the actuarial interest rate assumption, or preferably, in excess of this rate in order to improve the funded ratio of the Fund through investment earnings and favorably impact future employer and employee contribution rates.
- Achieve a net, total long-term return that meets or exceeds an appropriate, composite Plan benchmark index on a five-to ten-year rolling time horizon. The composite benchmark index will be based on the asset allocation set forth in the Investment Plan approved by the Board.

#### **A. Rebalancing Policy**

The primary strategic objectives of rebalancing the Fund are to mitigate risk and enhance returns while meeting the liquidity needs of SERS. The specific risk mitigation objective is to keep the asset allocation and overall investment structure of the Fund consistent with the Investment Plan and the policy asset allocation and asset class goals contained within it. Due to changes in market movements, actual asset class balances will inevitably deviate from target allocations. These deviations cause the Fund to diverge from the asset allocation chosen by the Board and the expected risk and return attributes associated with it. This divergence, or tracking error, heightens the risk that the Fund may not achieve returns sought by the Board at the risk levels they deem prudent. The Investment Office will have authority to rebalance asset class exposures as necessary and prudent pursuant to the rebalancing policy which is incorporated by reference into this policy.

### **6. Investment Guidelines**

The allocation of funds to various types of investments is of utmost importance in structuring an efficient portfolio designed to meet the Fund's investment objectives. In order to assure the most beneficial allocation of funds, the Board shall, with the advice of SERS' investment staff, consultants, and investment managers, adopt an Investment Plan that will be revised and updated periodically but not less than every two years. This plan will set forth the long-term allocation ranges for the asset classes and identify work initiatives to be pursued over the near term. Furthermore, each investment manager shall abide by specific investment guidelines that will be consistent with this Policy and the Investment Plan so

as to ensure that the Fund's broad investment objectives will be met. The managers' specific investment guidelines may be amended from time to time by mutual written consent of the staff and the manager.

If at any time the economic, fiscal, or investment environment should change significantly during the investment horizon, it shall be the duty of the staff, investment managers, and consultants to so inform the Board and, if warranted, recommend modifications to the Investment Plan or adjustment to the allocation of investment assets.

In the application and implementation of this Policy and the Investment Plan, the Chief Investment Officer in consultation with the Board Chairman, has the authority to make investment decisions on behalf of the board in emergency situations. Emergency situations are defined as those that are unforeseeable and in the absence of action taken; the Fund may be adversely impacted. In the event such action is taken, the Board will be apprised as soon as practical, but no later than the next scheduled board meeting.

## **7. Prohibited Transactions**

Investment managers are prohibited from entering into any transactions on behalf of the Fund that are not expressly authorized by this Policy or by specific investment manager guidelines and all applicable laws and regulations. All managers and consultants shall disclose any and all economic positions that may conflict with SERS' investment objectives and guidelines.

## **8. Investment Manager Evaluations**

The Board endeavors not to make adverse retention decisions about investment managers based upon performance absent at least three years of performance data, recognizing that investment strategies are best assessed over full market cycles.

The Board's time horizon to review performance trends shall normally be over full market cycles, although the trend in investment experience over other time periods may be judged important. Any extreme or unusual events or trends will be considered when evaluating intermediate and short-term investment results. The Investment Manager Monitoring Policy has been developed in order to assist staff in applying consistent criteria to evaluate investment managers.

Notwithstanding the above, the staff will review manager performance, portfolio positioning, and transactions at least annually.

## **9. Corporate Governance Standards**

Good corporate governance promotes responsible business practices that serve as an integral component to a corporation's long-term value creation process and are an indispensable element of an effective corporate risk management program.

SERS is committed to improve corporate governance practices of the companies within the SERS portfolio. SERS' involvement includes: the development and periodic updating of the Board approved proxy-voting policy, voting proxies, active participation in groups working to improve and enhance corporate governance practices, and ad hoc responses to important issues that affect the value of the portfolio, such as letters responding to regulatory and legislative proposals.

The proposed updates to the proxy voting policies shall be prepared by the Investment Office and submitted to the Board for approval. In the update of the policies, the Investment Office shall seek to

develop best practices. Best practices shall be developed through relationships with groups working to improve and enhance corporate governance practices and input that focuses on improving corporate governance practices from other prominent plan sponsors.

In addition, SERS monitors and, where appropriate, incorporates best corporate governance practice recommendations from organizations into the proxy voting guidelines. As good corporate governance practices are not static, the annual proxy voting modifications are designed to reflect the current trends in the marketplace.

#### **A. Proxy Voting Procedures**

Stock proxies are voted in accordance with the following procedures:

1. The custodian bank forwards to SERS' proxy servicer or manager proxy statements for securities that SERS owns, excluding securities that are on loan, or investments in the form of pooled funds and limited partnerships.
2. SERS' proxy servicer or manager will vote all proxies in accordance with the Board's proxy voting guidelines, except those where a specific concern has been raised by a Board Member, manager, consultant, or staff member.
3. The proxy servicer or manager may also vote any proxy involving other issues essentially the same as those on which the Board's proxy voting guidelines are well defined.
4. With regard to proxies requiring special attention under the Board's proxy voting guidelines, as well as special issues not covered or anticipated by the proxy voting guidelines, proxies and all pertinent reference material shall be sent to the Chief Investment Officer, who will evaluate the issues with respect to the intent of the proxy voting guidelines. On issues not covered by the proxy voting guidelines, controversial, high-profile, and contested change of control issues, the Chief Investment Officer will consult with the Board's chairman to determine how such proxies will be voted. The Chief Investment Officer will then direct the proxy servicer or manager to vote the proxies accordingly.
5. The Chief Investment Officer shall regularly report to the Board the types of special issues that are being considered or that have been voted by the Chief Investment Officer.
6. The Chief Investment Officer shall cause to be maintained by SERS' proxy servicer, or manager, a listing of proxy votes cast in a calendar year. This report, along with all individual actions, shall be available for public inspection on SERS' Internet web site.

#### **B. Corporate Actions**

The custodian bank has standing instructions to forward notices of all corporate actions received, such as dividends, stock splits, mergers, acquisitions, spin-offs, or class action suits to SERS and/or its investment managers.

## **10. Trading and Brokerage Practices**

The Board delegates the responsibility for the selection of brokerage firms to its investment managers, provided the investment managers select and utilize brokers in accordance with Section IV, D-2 (“best execution”) of this Policy. Notwithstanding this practice, the Board reserves the right to enter into brokerage commission recapture programs, and to establish goals for directed commissions provided the managers’ investment processes are not being affected so as to adversely impact the Fund or place the Fund in a disadvantageous position relative to the managers’ other accounts. As such, managers may be requested to direct a percentage of their brokerage activity on behalf of SERS. The Board will select the brokerage firms that are designated to receive such directed commissions, and will communicate this information to the managers.

The Board also seeks to have managers direct trades through minority owned firms and reserves the right to establish proposed trading targets. However, the responsibility for the selection and use of minority brokerage firms is delegated to the investment managers.

Finally, all things being equal, the Board seeks to have investment managers trade through Pennsylvania-based brokers.

Efforts to monitor and control trading costs will be ongoing, and may include the periodic use of formal trading cost analyses.

## **11. Public Access to Records**

Records of investment transactions are maintained by the System at its office located at 30 North Third Street, Harrisburg, PA 17101. Requests for public inspection or copies of documents that are a matter of public record will be honored in a manner consistent with the Pennsylvania Right-to-Know Law (RTKL), 65 P.S. §§ 101 - 3104, and SERS’ Right-To-Know Law Policy regarding the dissemination of public information. Inquiries should be directed to SERS’ Right-to-Know Law Open-Records Officer. This Right-to-Know Law Policy is incorporated by reference into this Policy.

## **12. Procedures for Amending this Policy Statement**

This Policy may be amended from time to time by a majority vote of the Board.

### **13. Separate Documents Related to this Policy Statement**

The following documents are incorporated by reference into this Policy and as such are considered part of this Policy as though they were presented in entirety within this Policy:

1. SERS' Investment Plan  
(adopted by the Board)
2. Public Markets Investment Manager Investment Strategy Statements  
(negotiated as part of the contracting process after Board appointment)
3. Real Estate Statement of Investment Policy  
(adopted by the Board)
4. Private Equity Statement of Investment Policy  
(adopted by the Board)
5. U.S. and International Proxy Voting Policy  
(adopted by the Board)
6. Investment Manager Monitoring Policy  
(reviewed by Board)
7. Right-To-Know Law Policy  
(adopted by the Board)
8. Derivatives Investment Policy Statement  
(reviewed by Board)
9. Portfolio Rebalancing Policy  
(adopted by Board)
10. Investment Manager, Asset Class, and Fund Benchmarks as reported in the Quarterly Performance Report  
(reviewed by Board)
11. SERS' Securities Litigation Policy  
(adopted by Board)
12. SERS' Securities Lending Policy  
(reviewed by Board)

## 14. Glossary of Terms

**Asset Allocation** – Investment choice made among broad asset classes such as equities, fixed income securities, real estate, etc.

**Asset Liability Study** - A study that examines how well alternative investment strategies (differing asset allocations) address the objectives of a fund, specifically the fund’s “liabilities”. The study acts as a guidepost for the strategic asset allocation.

**Brokerage Commission** – Payment for administrative costs of trading securities; the cost for execution.

**Brokerage Commission Recapture** – Reimbursement to the Fund for a portion of the fee paid to a broker for executing a trade.

**Comprehensive Annual Financial Report (CAFR)** - A set of U.S. government financial statements comprising the financial report of a state, municipal or other governmental entity that complies with the accounting requirements outlined by the Governmental Accounting Standards Board.

**Corporate Governance** – The procedures by which a corporation conducts its affairs.

**Corpus** –Specifically, the investment portfolio of SERS.

**Fiduciary** – A fiduciary is a legal or ethical relationship of trust between two or more parties where one party has undertaken to act for and on behalf of another party in a particular matter in circumstances which give rise to a relationship of trust and confidence.

**Funded Ratio** - The ratio of a pension’s assets to its liabilities. A funded ratio greater than 100% indicates the pension has accumulated more assets than its liabilities. A funded ratio less than 100% indicates the pension does not have enough assets to cover its liabilities.

**Net Total Return** – Interest or dividend income plus any realized or unrealized capital gain (or loss) on an investment, net of any capital contributions or distributions from the corpus.

**Proxy** – An instrument empowering an agent to vote for a shareholder.

**Qualitative Oversight** – Analysis that evaluates important factors that cannot be precisely measured, e.g., experience, caliber of management, investment philosophy and strategy.

**Quantitative Oversight** – Analysis dealing with measurable factors, such as value of securities, the cost of capital, historical and projected patterns of sales, costs, profitability, returns, risk. Used in tandem with qualitative oversight to arrive at sound business and financial judgments.

**Risk** – The uncertainty of outcome or the likelihood of not meeting an objective.

**Sarbanes Oxley Act** - Congress passed the Sarbanes Oxley Act in 2002 that mandated new or enhanced standards for all U.S. public company boards, management and public accounting firms to improve financial disclosures in order to protect investors from the possibility of fraudulent accounting activities by corporations.

**Tracking Error** – The annual standard deviation of a manager’s performance results in comparison to the manager’s benchmark.

## 15. Appendix I

### **Title 71, Pennsylvania Consolidated Statutes, 5931. Management of fund and accounts.**

**(a) Control and management of fund.--**The members of the board shall be the trustees of the fund. Regardless of any other provision of law governing the investments of funds under the control of an administrative board of the State government, the trustees shall have exclusive control and management of the said fund and full power to invest the same in accordance with the provisions of this section, subject, however, to the exercise of that degree of judgment, skill and care under the circumstances then prevailing which persons of prudence, discretion and intelligence, who are familiar with such matters, exercise in the management of their own affairs not in regard to speculation, but in regard to the permanent disposition of the funds, considering the probable income to be derived therefrom as well as the probable safety of their capital. The trustees shall have the power to hold, purchase, sell, lend, assign, transfer or dispose of any of the securities and investments in which any of the moneys in the fund shall have been invested as well as of the proceeds of said investments, including any directed commissions which have accrued to the benefit of the fund as a consequence of the investments, and of any moneys belonging to said fund, subject in every case to meeting the standard of prudence set forth in this subsection.

**(b) Crediting of interest.--**The board, annually, shall allow the required interest on the mean amount for the preceding year to the credit of each of the accounts. The amount so allowed shall be credited thereto by the board and transferred from the interest reserve account.

**(c) Custodian of fund.--**The State Treasurer shall be the custodian of the fund.

**(d) Payments from fund.--**All payments from the fund shall be made by the State Treasurer in accordance with requisitions signed by the secretary of the board, or his designee, and ratified by resolution of the board.

**(e) Fiduciary status of board.--**The members of the board, employees of the board and agents thereof shall stand in a fiduciary relationship to the members of the system regarding the investments and disbursements of any of the moneys of the fund and shall not profit either directly or indirectly with respect thereto. The board may, when possible and consistent with its fiduciary duties imposed by this subsection or other law, including its obligation to invest and manage the fund for the exclusive benefit of the members of the system, consider whether an investment in any project or business enhances and promotes the general welfare of this Commonwealth and its citizens, including, but not limited to, investments that increase and enhance the employment of Commonwealth residents, encourage the construction and retention of adequate housing and stimulate further investment and economic activity in this Commonwealth. The board shall, through the Governor, submit to the General Assembly annually, at the same time the board submits its budget covering administrative expenses, a report identifying the nature and amount of all existing investments made pursuant to this subsection.

**(f) Name for transacting business.--**By the name of "The State Employees' Retirement System" or "The State Employees' Retirement System" all of the business of the system shall be transacted, its fund invested, all requisitions for money drawn and payments made, and all of its cash and securities and other property shall be held, except that, any other law to the contrary notwithstanding, the board may establish a nominee registration procedure for the purpose of registering securities in order to facilitate the purchase, sale or other disposition of securities pursuant to the provisions of this law.

**(g) Deposits in banks and trust companies.--**For the purpose of meeting disbursements for annuities and other payments in excess of the receipts, there shall be kept available by the State Treasurer an amount, not exceeding 10% of the total amount in the fund, on deposit in any bank or banks in this Commonwealth organized under the laws thereof or under the laws of the United States or with any trust company or companies incorporated by any law of this Commonwealth, provided any of such banks or trust companies shall furnish adequate security for said deposit, and provided that the sum so deposited in any one bank or trust company shall not exceed 25% of the paid-up capital and surplus of said bank or trust company.

**(h) Venture capital, private placement and alternative investments.--**The board in its prudent discretion may make any venture capital investment, private placement investment or other alternative

investment of any kind, structure or manner which meets the standard of prudence set forth in subsection (a).

**(i) Vehicles for authorized investments.--**The board in its prudent discretion may make any investments which meet the standard of prudence set forth in subsection (a) by acquiring any type of interest in a business organization existing under the laws of any jurisdiction, provided that, in any such case, the liability of the State Employees' Retirement Fund shall be limited to the amount of its investment.

**(j) Legislative declaration concerning certain authorized investments.--**The General Assembly finds and declares that authorized investments of the fund made by or on behalf of the board under this section whereby the board becomes a joint owner or stockholder in any company, corporation, association or other lawful business organization are outside the scope of the original intent of and therefore do not violate the prohibition set forth in section 8 of Article VIII of the Constitution of Pennsylvania.

(Oct. 7, 1975, P.L.348, No.101, eff. imd.; Mar. 4, 1982, P.L.141, No.45, eff. imd.; June 29, 1984, P.L.450, No.95, eff. imd.; Aug. 5, 1991, P.L.183, No.23, eff. imd.; Apr. 29, 1994, P.L.159, No.29, eff. imd.; Dec. 20, 1995, P.L.689, No.77, eff. imd.; May 17, 2001, P.L.26, No.9, eff. imd.)

**2001 Amendment.** Act 9 amended subsecs. (h), (i) and (j). See section 24 of Act 9 in the appendix to this title for special provisions relating to authorized investments.

**1994 Amendment.** See section 14 of Act 29 in the appendix to this title for special provisions relating to authorized investments of the State Employees' Retirement Board as described in subsec. (i).

**Cross References.** Section 5931 is referred to in section 5102 of this title; section 5611 of Title 53 (Municipalities Generally).



**pennsylvania**  
STATE EMPLOYEES' RETIREMENT SYSTEM

**Commonwealth of Pennsylvania  
State Employees' Retirement Board**

**Real Estate Statement of Investment Policy**

**Adopted April 21, 2004  
Amended December 7, 2016**

## Table of Contents

1. Introduction .....	3
2. Investment Objectives .....	3
A. Asset Allocation.....	3
B. Return Objective .....	3
3. Investment Policies.....	4
A. Investment Universe .....	4
B. Portfolio Composition.....	4
C. Risk Management .....	4
(i) Investment Structures.....	4
(ii) Diversification.....	6
(iii) Leverage.....	7
(iv) Investment Size .....	7
(v) Valuation.....	7
(vi) Vintage Year Diversification .....	7
(vii) International Investing.....	8
D. Investment Manager Selection, Control, and Monitoring .....	8
(i) Individually Managed Accounts.....	8
(ii) Pooled Investment Vehicles .....	10
E. Discretionary Authority.....	11
F. Performance Measurement Report .....	11

**Commonwealth of Pennsylvania**  
**State Employees' Retirement Board**  
**Real Estate Statement of Investment Policy**

Pursuant to Title 71, Section 5931, the Board of Trustees (“Board”) of the Commonwealth of Pennsylvania State Employees’ Retirement System ( the “Fund” or “System”) is establishing this Real Estate Statement of Investment Policy (“Policy”) to set forth the long–term objectives and policies for real estate investments. The Board may amend this Policy Statement in whole or in part or provide for certain exceptions to it.

**1. Introduction**

The Board has determined that, over the long term, inclusion of real estate should provide benefits to the Fund’s overall portfolio. The Board has established the following role for real estate:

1. Generate competitive long-term returns through capital appreciation and current income.
2. Lower overall Fund volatility through diversification to the Fund’s stock and bond portfolios.
3. Provide a moderate hedge against inflation.

In order to achieve these benefits, this Real Estate Statement of Investment Policy establishes the specific objectives and policies required for the implementation and oversight of the Fund’s real estate program. The objectives define the specific risk tolerance and return expectations for the program. The policies provide specifications for acceptable investment styles and management of the various risks associated with the asset class. The members of the Board, employees of the Board, and agents thereof shall stand in a fiduciary relationship to the members of the System within the constraints of the “prudent investor” standard.

**2. Investment Objectives**

**A. Asset Allocation**

The Board approves a strategic long–term asset allocation target for real estate as part of the Investment Plan that is based on analysis of the overall long-term opportunities. SERS’ Investment Office and Board will undertake an analysis to establish the optimal portfolio mix across real estate sectors.

**B. Return Objective**

The objective of the Real Estate program is to generate annualized net-of-fee returns that exceed its benchmark over a three- to five-year period, with the various components weighted according to long-term allocation targets within the asset class. SERS’ public market real estate (e.g., public REITs) performance will be measured over each consecutive rolling, three-year return period in accordance with SERS’ Investment Manager Monitoring Policy. SERS’ private market real estate

(e.g., private real estate separate accounts, commingled funds, timberland, and agriculture) performance will be measured over each consecutive rolling, five-year return period. The custom benchmark currently consists of three indices: NCREIF Fund Index - Open End Diversified Core Equity, S&P Developed Property Index for REITs, & CPI plus a 3% premium for Timber and Agriculture.

### **3. Investment Policies**

#### **A. Investment Universe**

The universe of investable real estate opportunities for the Fund is large and diverse and is constantly changing. The Fund anticipates that it will invest in, but it will not be limited to, the following sectors:

1. Private market equity and debt investments in real estate and real estate related companies.
2. Public market investments in real estate investment trusts (REITs) and real estate operating companies.
3. Private market equity investments in timber and agricultural properties.

#### **B. Portfolio Composition**

As part of the Investment Plan, the Board shall approve an optimal portfolio mix across various real estate sectors, including public and private real estate, timber and farmland (agricultural properties). Investments will be made within each sector that may cause the composition of real estate to vary from the optimal mix approved by the Board or from the composition of an approved benchmark for a particular sector, due to the less liquid nature of most private sector investments, the less frequent valuations, and the generally larger capital commitments to individual investments. These investments will be made for the purpose of causing the sector to achieve superior risk-adjusted returns in order to achieve the program's return objective and the benefits for which the allocation to the asset class was made. Examples of variances from the sector benchmark for private real estate may include property type and location diversification, operating cycle, and leverage. Each sector will be evaluated relative to its benchmark, and the evaluation will include an analysis of the composition of the sector relative to its benchmark.

#### **C. Risk Management**

Investments in real estate have risks, including property-level risks, investment manager risk, and real estate and capital market risks. The Fund will attempt to mitigate risk in a prudent manner. The following policies have been established to address and manage the risks involved with investing in real estate.

##### **(i) Investment Structures**

The Fund recognizes that real estate is an illiquid investment. Vehicles that maximize the Fund's control, including the ability to exit an investment are preferred, but the Fund acknowledges that it may use vehicles with limited control in order to achieve certain

goals, such as diversification, access to specialized investments, or manager expertise. Limiting the exposure to any single investment strategy and/or manager will be used to mitigate the risk associated with reduced investor control. The Fund will use the following investment structures:

#### Individually Managed Accounts

The Fund may purchase assets on a wholly owned basis through Individually Managed Account structures. The Individually Managed Account structure is the preferred investment vehicle due to its low cost structure and control features provided to SERS, except when pooled investment vehicles offer an identifiable advantage for accessing a particular investment opportunity. The Individually Managed Account manager may consider joint venture or co-investment ownership within Individually Managed Account structures.

Individually Managed Accounts are actively managed programs with managers buying and selling investments as market conditions and opportunities dictate. All investments are made within the scope of approved investment guidelines in each manager's respective investment management agreement, as well as this Real Estate Statement of Investment Policy. The size of each individually managed account will be determined with reference to the overall allocation to real estate and the level of purchase and sale activity in any given manager's portfolio.

It is the intent that over the long-term each individually managed account be self-funded; i.e., that new acquisitions be funded out of portfolio cash flows and sales proceeds. However, it is recognized that the timing of cash flows in these portfolios is difficult to forecast given the uncertainties and lead time involved with the purchase and sale of commercial real estate investments. In addition, it is understood that commercial real estate investments are stand-alone business entities that may require periodic investment of new cash, some of which may be unanticipated and time sensitive, in order to enhance the value of any given investment and honor legal, health and safety, or other obligations, to which the owner (a SERS controlled entity) is bound. At no time will the total amount funded to any individually managed account exceed the commitment amount plus total capital returned as monitored and reported by the real estate consultant to the Board.

The Investment Office and Consultant will monitor cash flow projections provided by the managers to ensure that the total real estate portfolio will remain within the allocation ranges provided within the Investment Plan. At no time, however, will an Individually Managed Account manager be required to liquidate investments at inopportune times for the purposes of rebalancing.

### Pooled Investment Vehicles

Investment opportunities may be accessed through the ownership of units or shares of a Pooled Investment Vehicle. Any legally organized vehicle is allowed, including, but not limited to, joint ventures, limited partnerships, public and private real estate investment trusts, insurance company separate accounts, and limited liability corporations. Preference will be given to those Pooled Investment Vehicles that offer greater investment and reporting transparency.

#### **(ii) Diversification**

The Fund will seek to diversify its real estate portfolio by the following:

#### Risk Strategy

Traditionally, private equity real estate investments have been categorized by the risk and return features of the underlying properties. SERS recognizes two broad categories: Core investments (operating and substantially leased properties) and other types of real estate investments generally categorized as “Non-Core”. Core investments are substantially leased (i.e., 60% or greater leased at time of acquisition) institutional quality, well-located assets primarily in the traditional property types: office, apartment, retail, industrial, and hotel. These properties generally offer relatively high current income returns, and as a result, a greater predictability of returns. The income component typically represents a majority of the expected total return of Core investments.

Non-Core real estate includes a variety of risk and return relationships, property types, and investment vehicles. Non-Core investments offer the opportunity to obtain higher risk-adjusted returns arising from the relatively inefficient real estate markets or real estate capital market imbalances. Non-Core investments generally carry higher risk and expected returns than Core investments. Non-Core includes higher property level risk (leasing, renovation, development or repositioning required); a degree of business or operating risk (e.g., hotels, senior housing, or investments in real estate operating companies); or non-traditional formats or properties (e.g., distressed assets or private to public market arbitrage activities).

SERS anticipates that approximately 40% of its real estate program will be targeted to Core investments, and 40% targeted to Non-Core investments.

#### Manager

No single investment manager shall manage more than 30% of the total real estate allocation determined by the Board. However, there may be instances when the “denominator effect,” special situations such as portfolio take-overs and value appreciation of investments, can suddenly cause an “out of balance” situation with regard to any given manager. When this type of situation occurs the Investment Office and real estate consultant will work with the affected manager to bring the portfolio back into balance

within a reasonable timeframe.

#### Property Type and Property Location

Diversification by property type and location will be monitored and prudently managed, but the Fund recognizes that its diversification relative to benchmark may vary due to current opportunities available in the market and expectations for optimal risk-adjusted returns going forward. Diversification by geography includes international investments.

#### **(iii) Leverage**

The Fund shall seek to constrain overall leverage within the real estate program to a loan-to-value ratio (“LTV”) of 50% at the time the debt is placed. The LTV ratio in the separate account portfolios shall not exceed 60% at the time that debt is placed. It is understood that market value fluctuations may cause the LTV of all or a component of the program to exceed the limits expressed herein; in such an event, SERS shall not be required to sell investments or pay down debt in order to meet LTV limits expressed herein. The preference is to provide the managers the discretion to use leverage within contractual guidelines, when accretive to returns, without significantly increasing risk; however, debt that is recourse to a separate account will not be permitted unless approved by SERS’ Investment Office.

#### **(iv) Investment Size**

At no time shall the net investment amount in a single property within an Individually Managed Account exceed five percent (5%) of the net market value of the total Fund’s real estate portfolio at the time of initial investment. The Fund’s investment in a single closed-end Pooled Investment Vehicle may not exceed five percent (5%) of the net market value of the real estate portfolio at the time of initial investment. The Fund’s investment in a single open-end pooled fund may not exceed 15% of the net market value of the real estate portfolio at the time of initial investment.

#### **(v) Valuation**

All investments in an Individually Managed Account will be independently valued not less than once every three years by a qualified Member Appraisal Institute (MAI) designated appraiser approved by SERS’ Investment Office. During interim periods, the Investment Manager responsible for the investments will perform the valuations. Investments held in Pooled Investment Vehicles shall be valued using the methodology approved with the selection of the Pooled Investment Vehicle.

#### **(vi) Vintage Year Diversification**

SERS’ Investment Office shall prudently monitor and manage the vintage year exposure of the total real estate portfolio, but the Fund recognizes that vintage year exposures will vary due to current opportunities and the expectations for optimal risk-adjusted returns available

in the market.

**(vii) International Investing**

Targeted international investments totaling up to 20% of the total real estate portfolio shall be permitted as approved by the Board. Incidental non-domestic real estate exposure may exist from Pooled Investment Vehicle investments.

**D. Investment Manager Selection, Control, and Monitoring**

**(i) Individually Managed Accounts**

The following procedures will be used in the selection and monitoring of investments in Individually Managed Accounts.

Manager Selection Process

- Investment managers (both Individually Managed Account and Pooled Investment Vehicle managers) must have significant and direct experience investing and managing money for institutional investors. The manager must have expertise and experience in pricing, selection, structuring, and negotiating real estate investments. It is preferable that key investment personnel have a successful track record of implementing the strategy proposed for this investment, and managing portfolios of capital similar in size to the amount currently sought. Staff and Consultant shall establish specific qualification criteria, desired levels of competency, and respective evaluation factors consistent with the purpose of each search for an Individually Managed Account manager.
- Staff and Consultant shall meet with, review, and evaluate preferred candidates based upon the established criteria.
- Staff and Consultant shall recommend to the Board in writing the manager or managers to be interviewed and selected by the Board.

Control and Monitoring

a. Preliminary Investment Summary

Individually Managed Account managers shall have full discretion over the acquisition, management, and sale of individual investments. Prior to closing an investment, the manager shall provide a Preliminary Investment Summary to Staff. The preliminary package shall include an analysis of the merits, projected return, and exit strategy for the proposed investment, together with sufficient information for SERS' Investment Office to confirm the proposed investment's consistency with this Real Estate Statement of Investment Policy and the

investment manager's guidelines and strategy under its investment management agreement.

b. Reporting

Individually Managed Account managers shall adhere to the most recent version of the Real Estate Information Standards established jointly by the National Council of Real Estate Investment Fiduciaries, the Pension Real Estate Association, and the National Association of Real Estate Investment Managers, as well as, generally accepted accounting principles (GAAP). Managers will submit on an annual basis a third-party audited financial statement of the account managed by the Individually Managed Account manager.

c. Responsible Contracting

Managers of the Fund's wholly-owned assets in Individually Managed Accounts shall support and encourage the engagement of responsible contractors to provide building construction and maintenance services for such assets, subject to adherence to the Fund's fiduciary principles of loyalty, care, skill, prudence, and diligence. In all respects, such managers shall recognize and adhere to the principle that only the involved contractor has control over (1) the means and manner by which the contracted services are provided, and (2) the contractor's labor relation policies.

A responsible contractor is a contractor who, among other things: (1) has the appropriate experience, reputation, employee relations, responsiveness, fees, and dependability to perform required work; and (2) provides workers a fair wage and fair benefits for the required work, based on local market conditions. The utilization of such contractors may add value to the Funds' investments by ensuring that essential building and construction services are provided by adequately trained, experienced, and motivated workers.

The Board recognizes the right, as provided by law, of eligible employees to organize into a union or to not organize into a union, as the employees choose, and encourages contractors providing building construction and management services for the Fund's wholly-owned assets in Individually Managed Accounts to recognize and not impermissibly interfere with the lawful exercise of those rights and, upon a proper request, to bargain in good faith with any such lawfully recognized union.

Managers of the Fund's wholly-owned assets in Individually Managed Accounts and contractors providing building construction and maintenance services for such assets shall comply with applicable federal, state, and local laws, regulations and ordinances, including (but not limited to) those related to insurance, tax withholdings, minimum wage, health and safety, labor, and environmental matters.

With respect to those assets that the Fund does not wholly-own, it is desirable that the entity owning such assets comply with the foregoing policy statement.

d. Budget and Management Plan

Not more than 90 days after the end of the calendar year, Staff and Consultant shall meet with the manager of personnel directly responsible for an Individually Managed Account portfolio and asset management for a review and evaluation of the Manager's Budget and Management Plan, which shall include a summary of the prior year's financial performance, budgeted projections for the ensuing year, and the Manager's current hold/sell recommendation for each property.

**(ii) Pooled Investment Vehicles**

The following procedures will be used in the selection and monitoring of investments in Pooled Investment Vehicles.

a. Selection Process

Staff and Consultant will conduct screenings of the universe of available investment offerings that may be identified through Consultant's real estate databases, meetings with fund sponsors and their agents, and established SERS' relationships. The initial screen will focus on the identification of high quality candidates that clearly meet SERS' real estate investment guidelines and strategy, and which conform to the diversification and other risk management policies set forth in SERS' Investment Plan and Real Estate Statement of Investment Policy.

After identifying potential candidates, Staff and Consultant will conduct due diligence to ascertain which will provide optimal investment opportunities for SERS. The candidates will be assessed across a variety of criteria, including but not limited to:

- investment track record;
- quality, stability, depth and experience of investment professionals;
- clearly defined investment strategy that complements or is otherwise accretive to SERS' current or projected real estate portfolio construction;
- alignment of general partner's interests with limited partners' interests;
- adequacy of operational, accounting, legal compliance and reporting systems and personnel;
- terms and conditions of the fund, including but not limited to fees, promoted interests, key person provisions and removal and/or replacement of the general partner by the limited partners;
- client base and references; and
- unique advantages to the investment that benefit SERS, such as negotiation of preferred fees by Staff and/or Consultant.

If due diligence efforts are favorable, staff and consultant shall recommend to the

Board in writing the Pooled Investment Vehicle manager or managers to be interviewed and selected by the Board.

b. Closing Process

Completion of due diligence requires Fund counsel's review of the Pooled Investment Vehicle's formation and associated legal documents.

c. Control and Monitoring

Manager shall provide unaudited quarterly statements and reports and annual audited statements, which comply with generally accepted accounting procedures (GAAP). Annual meetings are typically conducted to discuss important developments regarding investment and management issues.

**E. Discretionary Authority**

The Board provides complete investment discretion within contractual guidelines to its managers regarding the acquisition, management, and disposition of real estate holdings.

**F. Performance Measurement Report**

Consultant shall provide performance measurement reports on a quarterly basis reviewing compliance with the Investment Plan and this Policy Statement. The report shall also include attributes for both the investment managers and the total portfolio including: income, appreciation, gross and net returns; cash flow; diversification; and comparisons with relevant industry performance indices.



**Commonwealth of Pennsylvania  
State Employees' Retirement Board**

**Private Equity Statement of Investment Policy**

**Adopted April 21, 2004**

**Amended December 7, 2016**

## Table of Contents

1. Introduction.....	3
2. Investment Objectives.....	3
3. Asset Allocation.....	3
4. Pacing.....	4
5. Investment Guidelines.....	4
a. Investment Strategy.....	4
b. Investment Process.....	5
c. Management.....	5
d. Terms and Conditions.....	5
6. Risk Management.....	5
7. Manager Monitoring and Evaluation.....	6
8. Separate Documents Incorporated by Reference into this Policy Statement.....	7
a. Hiring Investment Managers Process.....	7
b. SERS' Master Due Diligence Questionnaire.....	7
c. Due Diligence Questionnaire for Private Equity.....	7

**Commonwealth of Pennsylvania**  
**State Employees' Retirement Board**  
**Private Equity Statement of Investment Policy**

Pursuant to Title 71, Section 5931, the Board of the Pennsylvania State Employees' Retirement System ("SERS") establishes this Private Equity Statement of Investment Policy (the "Policy Statement") that sets forth the long-term objectives and policies for managing SERS' Private Equity program. The Policy Statement ensures that managers, advisors, and other third party service providers selected by the Board adhere to SERS' investment principles and guidelines. Additionally, the use of the Policy Statement assures sufficient flexibility in managing investment risks and returns associated with Private Equity. The Board may provide for exceptions, or amend this Policy Statement, in whole or in part.

**1. Introduction**

Private Equity is largely comprised of non-traditional investments made in limited partnerships organized to make domestic and international private market investments such as venture capital, leveraged buyouts, distressed debt, and special situations acquired in primary or secondary markets. Venture capital investments generally involve the financing of young, non-public growth companies. These investments are made in: (i) seed stage companies in their conceptual phase, (ii) early stage companies after a product has been developed but before revenues are realized, and (iii) late stage companies with demonstrable revenue and attraction for strategic sale or initial public offering of stock. The term "private equity" is employed to describe private market investments in the equity and subordinated debt of established companies.

The members of the Board, SERS' employees, and SERS' agents shall stand in a fiduciary relationship to the members of the System within the constraints of the "prudent investor" standard.

**2. Investment Objectives**

Private Equity investments are expected to provide return premiums over publicly traded securities, improve the Fund's diversification, and enhance the Fund's asset base over long periods of time. SERS' long-term performance objective for Private Equity is to achieve a risk-adjusted return, net of fees, in excess of the 10-year average annualized return of the Russell 3000 Index plus a 300 basis point risk premium.

**3. Asset Allocation**

Asset allocation is a critical driver of the long-term success of Private Equity. Since it is not possible to rebalance quickly in Private Equity, pacing and manager selection have heightened importance as tools to influence allocation. Long-term asset allocation targets are established in SERS' Investment Plan.

Fund investments should be planned and executed in a manner that adheres to the asset allocation targets (transitional and long-term) specified for Private Equity in SERS' Investment Plan. Rather than using discrete percentages, these targets are combined with those targets for global public equity and are expressed as a desired asset allocation range for all of SERS' equity-like investments entitled "Total

Equity.” By allowing acceptable allocation ranges, the Fund is not forced to constantly rebalance its assets, thus improving the Fund’s operational efficiency. Likewise, commitments to the Private Equity asset class may exceed carrying values since committed capital is typically drawn down over a long time period. During this period, some investments will be realized, resulting in distributions of capital back to SERS.

#### **4. Pacing**

SERS’ Investment Plan may recommend annual commitment ranges to be made by the Fund within each strategy as well as a total target commitment for the Fund (the “Pacing Analysis”) in order to achieve both the target strategic allocation and the overall allocation to the Private Equity asset class. The Pacing Analysis shall take into account the Fund’s overall allocation to and investments in the Private Equity asset class, within each strategy, across industries and geography, and by vintage year, as well as the market environment and other appropriate considerations. The Fund shall strive to avoid concentrations in strategies, industries, geographic areas, funds, managers, or vintage years.

#### **5. Investment Guidelines**

In an attempt to control the risks inherent in Private Equity, SERS strives to invest with private equity managers (“Manager(s)” or “Firm(s)”) capable of attaining SERS’ long-term investment objectives. Selection shall be predicated upon a comprehensive review of each prospective investment Manager’s current abilities and investment track record to determine if the investment return objectives are likely to be achieved, as articulated in SERS’ Investment Plan. Collectively, these Fund investments will be broadly diversified in terms of vintage year, industry focus, geographic focus, venture capital stage (e.g., seed, early, growth, or later stage), and private equity focus (e.g., buyouts, distressed, secondaries, or other). Exposure to Pennsylvania-based Managers may be a component of SERS’ Private Equity program if achieved within the fiduciary constraints of the “prudent investor” standard. SERS may invest in “fund-of-funds,” separately managed accounts, or other vehicles, if by doing so SERS achieves access to investment opportunities and/or information that might not otherwise be attainable.

SERS’ Private Equity investments shall satisfy the following minimum criteria:

##### **a. Investment Strategy**

The investment strategy must target investments that satisfy SERS’ definition of Private Equity. There must be a sufficient universe of potential investments to accommodate institutional investing. The investment strategy must be set forth in sufficient detail to permit substantive and meaningful review of the opportunity, verification of investment concept, and comprehensive analysis of risk factors. The investment strategy shall also outline the Firm’s corporate governance policies and procedures with respect to management of the Firm and its underlying investments. Finally, there must be sound evidence that the investment will provide reasonable probability of achieving the return and risk objectives of SERS.

## **b. Investment Process**

The Firm shall demonstrate a sound process for sourcing, performing due diligence, selecting, monitoring, and exiting investments. This investment process shall describe the Firm's internal investment and management controls, and should provide for regular monitoring and valuing of existing investments, as well as a strategy and procedure for exiting investments. The Fund shall have carefully documented its investment processes, including those related to hiring managers to manage the Fund's investments. These processes and due diligence tools are available for review on the SERS' intranet web page and are incorporated by reference into this policy.

## **c. Management**

The Manager must have expertise and experience in sourcing, pricing, selection, structuring and negotiating private equity investments. It is preferable that the Firm's key investment personnel have direct experience investing for institutional investors, a history of working together, a successful track record of implementing the strategy proposed for the particular investment, and are managing portfolios of capital similar in size to the amount currently being sought. Depending on the strategy, operational experience in target industries is desirable.

## **d. Terms and Conditions**

Each partnership agreement shall be negotiated such that SERS receives competitive terms and conditions. SERS' leverage to negotiate terms may be reduced when it commits relatively modest capital or if the Firm's offering is heavily oversubscribed.

## **6. Risk Management**

SERS will seek to minimize risk through investment due diligence and portfolio diversification. Before any investment is recommended to the Board and an investment is made, SERS' Investment Office staff and/or its Private Equity consultant will rigorously review the investment opportunity. A due diligence review by SERS' Investment Office staff and/or Private Equity consultant includes without limitation, meetings with the investment principals, reviews of pertinent offering documents and supporting materials, the Manager's completion of a due diligence questionnaire, and reference checks. Such reviews allow SERS to more effectively evaluate the soundness of the investment opportunity, and its adherence to SERS' investment guidelines as to investment strategy, process, management, and terms and conditions (see Section 5 above).

SERS will also seek to minimize risk within its Private Equity portfolio by diversifying its investments. Diversification will be achieved by investing with Managers in funds with differing vintage years, industry focuses, geographic focuses, venture capital stages, and private equity focuses. In addition, individual funds will be diversified by limiting the amount of capital that can be invested in any one company.

## **7. Manager Monitoring and Evaluation**

Each Manager will provide SERS' Investment Office with quarterly unaudited reports (or semi-annual reports if customarily produced by the Manager) and annual audited reports in sufficient detail to allow SERS' Investment Office staff to assess the performance of each Private Equity investment. Each Manager is expected to timely report on all material developments including, but not limited to, personnel changes, contractual problems or amendments, distribution issues, and any other items required for appropriate monitoring by SERS' Private Equity staff. Each Manager, as part of its investment report to SERS, is expected to provide information concerning its Pennsylvania portfolio activity (if any), including employment statistics.

Semiannually, the Private Equity consultant will submit to the Board a Private Equity performance report. Performance measurement will utilize an Internal Rate of Return metric ("IRR"). The IRR is based on inflows and outflows of partnership capital, giving consideration to the residual value of investment holdings, and calculated net of management fees, expenses, and the Manager's share of carried interest. The IRR calculation is an annualized-since-inception measure, updated quarterly, and along with cash-on-cash return multiples, serves as the primary objective measurement of a Manager's performance. The performance of each investment will be compared against Burgiss' relevant Vintage Year Median Returns (or other relevant relative return data made available by SERS' Private Equity consultant).

The Board understands that Private Equity investments are long term in nature, illiquid, and generally involve a duration of 8 to 15 years. Therefore, investment performance must be viewed over a longer time horizon than the assessment period used for publicly traded securities. Although the final performance of a Private Equity investment cannot be known until its termination, it is recognized that the performance of a more mature investment (7-10 years) provides a more accurate indication thereof.

For SERS' Investment Office staff to more actively monitor a Manager's investments for compliance with the terms and conditions of the limited partnership agreement as well as SERS' expectations, SERS often seeks a seat on the fund's advisory board or valuation committee. In such capacity, SERS' Investment Office staff will generally participate in the review and/or approval of: (i) the Manager's valuation policy, (ii) underlying investments remaining in the portfolio, (iii) the Manager's valuation of such underlying investments, and (iv) whether potential conflicts of interest exist. As the size of SERS' commitments shrinks, so does the likelihood that it will be offered opportunities to serve on their advisory boards and valuation committees.

**8. Separate Documents Incorporated by Reference into this Policy Statement**

- a. Hiring Investment Managers Process**
- b. SERS' Master Due Diligence Questionnaire**
- c. Due Diligence Questionnaire for Private Equity**



**Commonwealth of Pennsylvania  
State Employees' Retirement Board**

**Investment Manager Monitoring Policy**

**Adopted October 29, 2014**

**Amended December 7, 2016**

SERS employs external investment managers to manage pension fund assets. SERS' Statement of Investment Policy charges the Investment Office with responsibility for coordinating all investment activities and matters for SERS, including the continual review and analysis of investment managers. It also allows for the use of external investment consultants to provide various investment-related services, including assistance with the analysis of investment managers.

SERS Investment Office, in consultation with its external general investment consultant and external real estate investment consultant, developed this Investment Manager Monitoring Policy ("Policy"). The purpose of this Policy is to provide the SERS Board with an enhanced communication tool to keep the Board informed of investment managers that warrant additional monitoring by SERS Investment Office and external consultants.

An Investment Manager Evaluation List (Appendix 1) was developed to clearly communicate which investment managers have been identified as experiencing quantitative or qualitative pattern changes worthy of greater review by SERS Investment Office and external investment consultants. Although a quantitative analysis is clearly important, it is not a best practice to rely exclusively on such data when evaluating investment managers due to the imperfect nature of many indices used as portfolio benchmarks. In addition, the placement of an investment manager on the Investment Manager Evaluation List does not automatically serve as evidence of a problem with the investment manager. This can only be determined after SERS Investment Office and external investment consultants enhance its ongoing monitoring.

#### **A. Investment Manager Monitoring Guidelines and Evaluation List**

The Investment Manager Monitoring Guidelines formalize the identification and application of qualitative and quantitative criteria employed by SERS with respect to the monitoring of current investment managers in the following asset classes of the SERS investment program.

- Global Public Equity
- Public REITs
- Hedge Funds
- Fixed Income
- Cash

The Investment Manager Monitoring Guidelines:

- 1) establish clear expectations between the SERS Board, Investment Office, external investment consultants, and investment managers,
- 2) enhance communication among the SERS Board, Investment Office, external investment consultants,
- 3) encourage the use of prudently applied criteria to evaluate investment managers,
- 4) foster a long-term approach toward performance evaluation of investment managers,
- 5) focus the resources of SERS Investment Office and external investment consultants on those investment managers most likely to require additional attention,

- 6) avoid costly turnover in investment management relationships driven by a period of short-term poor performance, and
- 7) improve the probability that SERS will identify problematic relationships which otherwise might produce unsatisfactory investment returns.

In general, the Investment Manager Monitoring Guidelines apply to investment managers with assets that are valued at least monthly. Investment managers that are in liquidation are excluded from the Investment Manager Monitoring Guidelines.

The SERS Board endeavors not to make adverse retention decisions about investment managers based upon performance absent at least three years of performance data, recognizing that investment strategies are best assessed over full market cycles. All of the criteria identified in the Investment Manager Monitoring Guidelines are intended to provide a normal, minimum standard for retaining investment managers.

However, the SERS Board may terminate any current investment manager for any reason whatsoever in accordance with the provisions of investment management agreements between SERS and the external investment managers. These Investment Manager Monitoring Guidelines do not limit SERS ability to take such action.

## **B. Criteria for Active and Passive Management**

### Addition to the Investment Manager Evaluation List

SERS Investment Office, in consultation with its external investment consultant, will place an investment manager on the Investment Manager Evaluation List for any of the following reasons:

#### Quantitative Factors

1. The active investment manager's rolling, three-year return falls below the rolling, three-year benchmark return for four (4) consecutive quarters. This is a net of fee comparison.
2. The active investment manager's rolling, three-year return ranks below the median of the external investment consultant's peer group for four (4) consecutive quarters (excludes investment managers with no relative peer group). This is a gross of fee comparison.
3. The passive investment manager's rolling three-year return is not in line with the rolling, three-year benchmark return. SERS Investment Office and the external investment consultant will determine what variance from the benchmark is deemed acceptable, given the passive strategy. This is a net of fee comparison.
4. The active or passive investment manager's return significantly deviates from its expected return established in its investment strategy statements (investment guidelines) with SERS. This is a net of fee comparison.

## Qualitative Factors

1. A significant and potentially adverse event related, but not limited, to any of the following qualitative issues or events, will be considered:
  - Violation of investment guidelines
  - Deviation from stated investment style and/ or shifts in the firm's philosophy or process
  - Turnover of one or more key personnel
  - Change in firm ownership or structure
  - Significant loss of clients and/or assets under management
  - Significant and persistent lack of responsiveness to client requests
  - Litigation
  - Failure to disclose significant information, including potential conflicts of interest
  - Chronic violations of the SERS' Statement of Investment Policy
  - Any other issue or situation of which SERS Investment Office, external investment consultants, and/or SERS Board members become aware that is deemed material.

### Removal from the Investment Manager Evaluation List

An investment manager may be removed from the Investment Manager Evaluation List when SERS' Investment Office and the external investment consultant agree that the investment manager has satisfactorily met the quantitative or qualitative criteria for removal from the Evaluation List. Generally for active investment managers, two consecutive quarters of rolling, three-year performance above the benchmark and a ranking above the median of the external investment consultant's peer group following placement on the Evaluation List will be required for an investment manager's removal from the Evaluation List for performance reasons. For index fund investment managers, one period of rolling, three-year performance in line with the benchmark following placement on the Evaluation List will be required for an investment manager's removal from the Evaluation List for performance reasons. SERS Investment Office and the external investment consultant will typically make a decision to recommend retention or termination twelve (12) months following placing an investment manager on the Evaluation List. At the point of decision, SERS Investment Office and the external investment consultant may recommend renewing inclusion on the Evaluation List for an additional period of time subject to supporting due diligence.

### **C. Application of Criteria**

1. The Investment Manager Evaluation List is a confidential internal document and will only be used for internal purposes.
2. SERS Investment Office, in consultation with external investment consultants, will provide the SERS Board with a current Investment Manager Evaluation List at the same board meeting when the general investment consultant's quarterly performance is provided to the SERS Board. The Evaluation List will include all investment managers which have been added or removed and summary of the reasons for the addition or removal.

3. The Investment Manager Evaluation List will be provided to the SERS Board in executive session.
4. When an investment manager is placed on the Investment Manager Evaluation List, SERS Investment Office and external investment consultants will enhance its ongoing monitoring of the investment manager to assess whether or not genuine issues of concern actually exist.
5. If genuine issues of concern are identified, SERS Investment Office and external investment consultants will assess the cause, magnitude, and likely duration of the issues.
6. If the analysis from SERS Investment Office and external investment consultants reveal that the issues are not of concern, the investment manager will be removed from the Investment Manager Evaluation List.
7. If the investment manager resolves the issues of concern to the satisfaction of SERS Investment Office and external investment consultants, the investment manager will be removed from the Investment Manager Evaluation List.
8. If SERS Investment Office and external investment consultant determine that the issues of concern have persisted without satisfactory resolution or are unlikely to be resolved within 12 months, then a recommendation on whether to retain the investment manager will be provided to the SERS' Board.
9. In emergency situations, the Chief Investment Officer, in consultation with the Chairman of the SERS Board, may make investment decisions (i.e., halt trading or terminate an investment manager). Emergency situations are defined as those that are unforeseeable and in the absence of action, the Fund may be adversely impacted. In the event such action is taken, the SERS Board will be notified as soon as practical, but no later than the next scheduled board meeting. This is defined in SERS' Statement of Investment Policy.

## Appendix 1: Investment Manager Evaluation List (TEMPLATE)



### Memorandum

To SERS Board Members  
 From SERS Investment Office and RVK  
 Subject Investment Manager Evaluation List  
 Date <insert date>

The following is the Investment Manager Evaluation List (“Evaluation List”) as of <insert quarter-end date>. The Evaluation List is compiled in conformance with the criteria established in the Investment Manager Monitoring Policy adopted by the Board on October 29, 2014.

The placement of an investment manager on the Evaluation List does not automatically serve as evidence of a problem with the investment manager. The Evaluation List was developed to clearly communicate which investment managers have been identified as experiencing quantitative or qualitative pattern changes worthy of greater review by SERS Investment Office and external investment consultants.

### Summary

Manager	Asset Class	Strategy	Assets	Event Date
<b>1. Additions Since Last Report</b>				
<b>2. On Evaluation List</b>				
<b>3. Deletions Since Last Report</b>				

### Evaluation List

Manager	Reason	SERS Investment Office & RVK Recommendation

# **ATTACHMENT E**

## **EXECUTIVE SESSION MINUTES** **Meeting: December 7, 2016**

### **Executive Session**

- 1. Recent Decisions**
- 2. Act 163 of 2016 – Procurement Code Amendments**
- 3. SEC Matter (Keystone Venture Fund V)**
- 4. Pending Litigation**
- 5. Fund Update**
- 6. Real Estate Discussion**
- 7. Personnel Committee Discussion**
- 8. SERS 2017-2019 Strategic Business Plan Discussion**



**Commonwealth of Pennsylvania  
State Employees' Retirement Board**

**U.S. & International Proxy Voting Policy**

**Amended December 7, 2016**

## Table of Contents

<b>A. Routine Shareholder Meeting Formalities .....</b>	<b>3</b>
<b>B. The Board of Directors .....</b>	<b>5</b>
<b>C. Proxy Contests.....</b>	<b>12</b>
<b>D. Auditors .....</b>	<b>13</b>
<b>E. Takeover Defenses .....</b>	<b>15</b>
<b>F. Miscellaneous Corporate Governance Provisions .....</b>	<b>19</b>
<b>G. Capital Structure .....</b>	<b>22</b>
<b>H. Executive and Director Compensation .....</b>	<b>27</b>
<b>I. Incorporation.....</b>	<b>35</b>
<b>J. Mergers and Corporate Restructurings .....</b>	<b>36</b>
<b>K. Mutual Fund and Exchange Traded Fund Proxies .....</b>	<b>38</b>
<b>L. Social, Environmental and Political Issues.....</b>	<b>39</b>
<b>M. Lack of Information.....</b>	<b>40</b>

## Introduction

When the State Employees' Retirement System ("SERS") makes certain investments it becomes a holder of common stock in a publicly traded company. Common stock is a security that represents ownership in a corporation, and holders of common stock (known as shareholders) have certain rights pertaining to their equity investment. Among the most important of these is the right to exercise control of the company by voting on certain corporate matters, including voting to elect a board of directors, voting on corporate policy, etc. Shareholders can exercise their voting rights in person at the company's annual stockholders meeting or other special meeting convened for voting purposes, or by proxy.

A proxy vote is a ballot cast by one person or entity on behalf of a shareholder of a corporation that would rather cast a proxy vote than attend a shareholders meeting.

The following voting policies apply to all proxies in which SERS is entitled to vote. Unless otherwise noted below, these voting policies will apply globally, and will take into account market best practices, local corporate governance codes, and applicable listing standards. All proxy voting shall serve the best interests of SERS' beneficiaries through enhancement of long-term portfolio value, which should be reflected ultimately in the performance of the company. SERS will normally vote in accordance with the following policies:

### A. Routine Shareholder Meeting Formalities

In some markets, shareholders are routinely asked to approve certain routine meeting formalities and management proposals, which SERS will generally vote **for**, including without limitation:

- The opening of the shareholder meeting;
- That the meeting has been convened under local regulatory requirements;
- The presence of a quorum;
- The agenda for the shareholder meeting;
- The election of the chair of the meeting;
- The appointment of shareholders to co-sign the minutes of the meeting;
- Regulatory filings;
- The designation of an inspector or shareholder representative(s) of minutes of the meeting;
- The designation of two shareholders to approve and sign minutes of the meeting;
- The allowance of questions;
- The publication of meeting minutes; and/or
- The closing of the shareholder meeting.

#### 1. FINANCIAL STATEMENTS; DIRECTOR AND AUDITOR REPORTS

SERS will generally vote **for** approval of financial statements, as well as director and auditor reports, unless:

- There are concerns about the accounts presented or audit procedures used; and/or
- The company is not responsive to shareholder questions about specific items that should be publicly disclosed.

## 2. ALLOCATION OF INCOME AND DIVIDENDS

- SERS will generally vote **for** management proposals concerning allocation of income and the distribution of dividends, unless the amount of the distribution is consistently and/or unusually small or large.

## 3. STOCK (SCRIP) DIVIDEND ALTERNATIVES

- SERS will vote **for** most stock (scrip) dividend proposals.
- SERS will vote **against** proposals that do not allow for a cash option unless management demonstrates that the cash option is harmful to shareholder value.

## 4. CHANGE IN COMPANY FISCAL TERM

SERS will generally vote **for** resolutions to change a company's fiscal term, unless a company's motivation for the change is to postpone its Annual General Meeting (“AGM”).

## B. The Board of Directors

### 1. VOTING ON DIRECTOR NOMINEES IN UNCONTESTED ELECTIONS

#### U.S. Companies:

SERS generally evaluates the election of director nominees on a **case-by-case** basis. SERS will generally vote **for** the candidates suggested by the company, unless the existing board has not properly performed its responsibilities.

SERS generally votes **against** (or **withholds** its vote regarding) individual directors who:

- Attend less than 75 percent of the board and committee meetings for two consecutive years without a valid excuse (such as illness, service to the nation, work on behalf of the company);
- Sit on more than five public company boards; and/or
- Are CEOs of public companies who sit on the boards of more than two public companies besides their own -- withhold only at their outside boards.

SERS generally votes **against** (or **withholds** its vote regarding) all nominees of the board of directors (except new nominees, who should be considered on a **case-by-case** basis) if:

- The company's poison pill has a dead-hand or modified dead-hand feature (SERS will vote **against/withhold** every year until this feature is removed);
- The board adopts or renews a poison pill without shareholder approval, does not commit to putting it to a shareholder vote within 12 months of adoption (or in the case of a newly public company, within 12 months following the IPO), or reneges on a commitment to put the pill to a vote and has not yet received an against/withhold recommendation on the issue; and/or
- The board makes a material adverse change to an existing poison pill without shareholder approval.

SERS will vote **case-by-case** on all director nominees if the board adopts a poison pill with a term of 12 months or less ("short-term pill") taking into account the following factors:

- The date of the pill's adoption relative to the date of the next meeting of shareholders (i.e., whether the company had time to put the pill on the ballot for shareholder ratification given the circumstances);
- The issuer's rationale;
- The issuer's governance structure and practices; and/or
- The issuer's track record of accountability to shareholders.

SERS will vote **case-by-case** on individual directors, committee members, or the entire board of directors as appropriate if:

- The board failed to act on a shareholder proposal that received the support of a majority of the shares cast in the previous year;
- At the previous board election, any director received more than 50 percent withhold/against votes of the shares cast and the company has failed to address the underlying issue(s) that caused the high withhold/against vote;
- The board failed to act on takeover offers where the majority of the shareholders tendered their shares; and/or

The board implements an advisory vote on executive compensation on a less frequent basis than the frequency that received (i) the majority, or (ii) a plurality of votes cast at the most recent shareholder meeting at which shareholders voted on the say-on-pay frequency.

**Note:** If the board is staggered or classified (i.e., only a portion (often one third) of the board is elected at a time as opposed to all directors being chosen at once), and a continuing director who is not up for re-election is responsible for a problematic governance issue at the board/committee level that would warrant a **withhold/against** vote recommendation, any or all existing members that are nominees for re-election may be held accountable.

SERS generally votes **against** or **withhold** regarding all nominees of the board of directors if:

- The majority of the board is not independent;
- The audit, compensation, or nominating committees have not been established; and/or
- The audit, compensation, or nominating committees include non-independent directors.

SERS generally votes **against** or **withhold** regarding the members of the company's Audit Committee if:

- The non-audit fees paid to the auditor are excessive;
- The company receives an adverse opinion on its financial statements from its auditor; and/or
- There is persuasive evidence that the Audit Committee entered into an inappropriate indemnification agreement with its auditor that limits the ability of the company, or its shareholders, to pursue legitimate legal recourse against the auditor.

SERS votes on a **case-by-case** basis on members of the Audit Committee and/or the full board if certain poor accounting practices, or accounting issues of serious concern, are identified such as: (i) fraud; (ii) misapplication of Generally Accepted Accounting Principles (GAAP); and/or (iii) material weaknesses identified per the disclosures required by Section 404 of the Sarbanes-Oxley Act of 2002. SERS shall examine the severity, breadth, chronological sequence, and duration of the issue, as well as the company's efforts at remediation or corrective actions regarding same, when determining whether negative vote recommendations are warranted against responsible members of the Audit Committee or the entire board.

SERS generally votes **against** or **withhold** regarding members of the Compensation Committee if:

- There is a negative correlation between chief executive pay and company performance;
- The company re-prices underwater options for stock, cash or other consideration without prior shareholder approval, even if allowed in its equity plan;
- The company fails to submit one-time transfers of stock options to a shareholder vote;
- The company fails to fulfill the terms of a burn rate (i.e., a measure of negative cash flow, usually quoted in terms of cash spent per month) commitment made to shareholders;
- The company has backdated options; and/or
- The company has problematic compensation practices that may warrant "against" or "withhold" votes regarding the CEO and/or the entire board.

**Note:** If a management "say-on-pay" ("MSOP") proposal is on the ballot, SERS will use the MSOP as the primary focus of voting on executive compensation practices, as the MSOP provides a dedicated tool for shareholders to communicate dissatisfaction with compensation practices. However, in egregious cases, or if the board fails to respond to concerns raised by a prior MSOP proposal, then SERS may vote "against" or "withhold" regarding Compensation Committee members (or all directors, if appropriate).

Under extraordinary circumstances, SERS will vote **against** or **withhold** regarding individual directors, committee members, or the entire board, due to:

- Material failures of governance, stewardship, risk oversight, or fiduciary responsibilities to the company (e.g., bribery; large or serial fines; and/or sanctions from regulatory bodies);

- Significant adverse legal judgments or settlements, hedging of company stock, or significant pledging of company stock;
- Failure to replace management as appropriate; and/or
- Egregious actions related to a director's service on other boards that raise substantial doubt about his or her ability to effectively oversee management and serve the best interests of the company's shareholders.

#### **Unilateral Bylaw/Charter Amendments**

SERS generally votes **against or withhold** regarding individual directors, committee members, or the entire board (except new nominees, who should be considered on a case-by-case basis) if/when the board amends the company's bylaws or charter without shareholder approval in a manner that materially diminishes shareholders' rights or could adversely impact shareholders. In such cases, SERS shall consider the following factors:

- The board's rationale for adopting the bylaw/charter amendment without shareholder ratification;
- Disclosure by the company of any significant engagement with shareholders regarding the amendment;
- The level of impairment of shareholders' rights caused by the board's unilateral amendment to the bylaws/charter;
- The board's track record with regard to unilateral board action on bylaw/charter amendments or other entrenchment provisions (e.g., those that are more difficult to amend/require a supermajority);
- The company's ownership structure;
- The company's existing governance provisions;
- The timing of the board's amendment to the bylaws/charter in connection with a significant business development; and/or
- Other factors relevant in determining the impact of the amendment on shareholders.

**Note:** Unless the adverse amendment is reversed or submitted to a binding shareholder vote, SERS generally votes on a **case-by-case** basis on director nominees in subsequent years. That said, SERS will generally vote **against** (except new nominees, who should be considered on a case-by-case basis) if such directors:

- Staggered/Classified the board;
- Adopted supermajority vote requirements to amend the bylaws or charter; and/or
- Completely eliminated shareholders' ability to amend the bylaws or charter.

For newly public companies, SERS generally votes **against or withhold** regarding individual directors, committee members, or the entire board (except new nominees, who should be considered on a case-by-case basis) if, prior to or in connection with the company's public offering, the company or its board adopts bylaw or charter provisions adverse to shareholders' rights, considering the following factors:

- The level of impairment of shareholders' rights caused by the provision;
- The company's/board's rationale for adopting the provision;
- The provision's impact on the ability to change the governance structure in the future (e.g., limitations on shareholders' rights to amend the bylaws or charter, or supermajority vote requirements to amend the bylaws or charter);
- The ability of shareholders to hold directors accountable through annual director elections, or whether the company has a staggered/classified board structure; and/or
- A public commitment by the company/board to put the provision to a shareholder vote within three years of the date of the initial public offering.

**Note:** Unless the adverse provision is reversed or submitted to a vote of public shareholders, SERS will generally vote on a case-by-case basis on director nominees in subsequent years.

#### **Non-U.S Companies:**

SERS will vote on director nominees on a **case-by-case** basis, taking into account company practices, corporate governance codes, disclosure, and best practices, examining factors such as:

- Composition of the board and key board committees;
- Long term company performance relative to a market index;
- The company's corporate governance provisions and practices, as well as its takeover activity; and/or
- Any applicable corporate governance codes of the country in which the company is domiciled.

There are some actions by directors that should result in SERS automatically voting **against or withhold** (whichever vote option is applicable on the ballot). Such instances generally fall into the following categories:

- The board fails to meet minimum corporate governance standards;
- Adequate disclosure has not been provided to shareholders in a timely manner;
- There are clear concerns over questionable finances or restatements of the company;
- There are questionable transactions involving conflicts of interest between the company and the directors;
- There are records of abuses against minority shareholder interests;
- There are specific concerns about an individual director, such as criminal wrong-doing or breach of fiduciary responsibilities;
- There are material failures of governance, stewardship, risk oversight, and/or fiduciary responsibilities exist within the company;
- The failure to replace management as/when appropriate; and/or
- There are egregious actions related to a director's service on other boards that raise substantial doubt as to his or her ability to effectively oversee management and serve the best interests of shareholders.

**Note:** SERS will take market practices into account in identifying egregious behavior, and shall vote **against** the election of directors who have acted outside acceptable market practices. With that in mind, and to the extent that disclosure is available, SERS will generally vote **against** director nominees:

- Who attend less than 75% of board meetings held the previous year without a valid reason;
  - Where the board is not comprised of a majority of independent directors;
  - Who are non-independent and the board lacks formal Audit, Compensation and/or Nominating Committee(s);
  - Who are non-independent and serve on the Audit, Compensation, and/or Nominating Committee(s);
- Who ignored a majority-supported shareholder proposal during the previous year. "Majority" support is defined as a majority of votes cast, not shares outstanding. If a board fails to act on a shareholder-sponsored proposal that is supported by a majority of shares outstanding, SERS will vote "against" or will withhold votes from all existing board member nominees at the next annual meeting.

## 2. DISCHARGE OF THE BOARD AND/OR MANAGEMENT

The annual formal discharge of the board and/or management from liability in respect of their duties represents shareholder approval of actions taken during the previous fiscal year. Discharge is a tacit vote of confidence in the company's management and policies. Withholding discharge is a serious matter and is advisable only when a shareholder has (i) substantial/material evidence of negligence or abuse on the part of the board and/or management, (ii) intends to take legal action, and/or (iii) has knowledge of other shareholders' intentions to take legal action.

SERS will generally vote **for** discharge of the board and/or management, unless:

- There are serious questions/concerns about actions of the board and/or management for the year in question; and/or
- Legal action is being taken or considered against the board and/or management by a shareholder.

## 3. INDEPENDENT CHAIR (SEPARATION OF CHAIRMAN/CHIEF EXECUTIVE OFFICER)

In general, companies should give careful consideration to separating the office of Chairman and Chief Executive Officer. The Chairman should be an independent director. Where Boards do not separate these two positions, a Presiding Director position should be established. The duties of the Presiding Director should be clearly delineated. Boards that choose not to take this approach should clearly explain their opposition.

That said, in cases where investment returns have exceeded the peer group average or the relevant index, SERS will generally vote **against** a separation of these positions.

In cases where investment returns have trailed the peer group average or the relevant index, the shareholder proposals to require an independent board chair will be voted on a **case-by-case** basis considering the following factors:

- The scope of the proposal;
- The company's current board leadership structure;
- The company's governance structure and practices;
- Company performance; and
- Any other factors that may be relevant/applicable.

## 4. INDEPENDENT DIRECTORS

SERS believes that performance should be the key factor in determining the effectiveness of a board. Independent, outside directors are often critical in achieving and maintaining superior financial performance. A director is deemed to be independent if the only non-trivial professional, familial, or financial connection to the corporation, its chairman, CEO, or any other executive officer is his or her directorship. In addition, if a non-employee director is deemed non-independent based on the relevant listing standards or board attestations, SERS will categorize the such director as an affiliated outsider.

Additionally, SERS desires full disclosure of all financial and business relationships of, and payments to, the directors or their companies, non-profits, foundations and other organizations where company directors serve as employees, officers, or directors to ensure that the board is truly independent.

Therefore, SERS will generally vote **for** shareholder proposals:

- Asking that boards be comprised of at least two-thirds of independent directors;

- Asking that board's Audit, Compensation, and Nominating Committees be comprised exclusively of independent directors; and/or
- Asking that all other board committees be comprised of a majority of independent directors.

## 5. MAJORITY VOTE SHAREHOLDER PROPOSALS

SERS will generally vote **for** reasonably crafted shareholder proposals calling for directors to be elected with an affirmative majority of votes cast and/or the elimination of the plurality standard for electing directors (including binding resolutions requesting that the board amend the company's bylaws), provided the proposal includes a carve-out for a plurality voting standard when there are more director nominees than board seats (i.e., contested elections). SERS will also carefully evaluate companies who adopt a post-election policy (also known as a director resignation policy) that will provide guidelines that ensure the company will promptly address the situation of a holdover director.

## 6. STOCK OWNERSHIP REQUIREMENTS

SERS will vote **for** proposals requiring a director to own a minimum amount of company stock.

SERS will generally vote **against** a director who owns less than 100 shares of company stock and has served on the board for more than one year.

## 7. TERM OF OFFICE

SERS will vote **against** any management or shareholder proposal to limit the term that outside directors may serve on the board, including without limitation through mandatory retirement ages. An "outside director" is any member of a company's board who is not an employee or stakeholder in the company.

However, SERS will scrutinize boards where the average tenure of all directors exceeds 15 years in consideration of factors such as independence from management, and sufficient turnover, to ensure that new perspectives are being added to the board.

## 8. DIRECTOR AND OFFICER INDEMNIFICATION AND LIABILITY PROTECTION

Proposals concerning director and officer indemnification and liability protection are evaluated on a **case-by-case** basis.

SERS will generally vote **against** proposals to limit or eliminate entirely director and officer liability for monetary damages for violating their duty of care.

SERS will generally vote **against** indemnification proposals that would expand coverage beyond just legal expenses to acts, such as negligence, that are more serious violations of fiduciary obligations than mere carelessness.

SERS will generally vote **for** only those proposals that provide such expanded coverage in cases when a director's or officer's legal defense was unsuccessful if:

- The director was found to have acted in good faith and in a manner that he or she reasonably believed was in the best interests of the company; and/or
- Only the director's or officer's legal expenses would be covered.

## 9. INCREASE/DECREASE IN BOARD SIZE

SERS favors smaller boards comprised of a majority of independent directors. A board should neither be too small to maintain needed expertise and independence, nor too large to be efficiently functional. Absent compelling and/or unusual circumstances, a board should have no fewer than 5 and no more than 15 members.

SERS will generally vote **for** management proposed changes in board size if there are clear and justifiable reasons to do so, and are not intended as an anti-takeover move designed to entrench management.

## C. Proxy Contests

### 1. VOTING ON DIRECTOR NOMINEES IN PROXY CONTESTS

All items related to a contested election of directors and proxy access nominees will be referred to SERS' Chief Investment Officer, who will evaluate votes on a **case-by-case** basis, analyzing both sides of the contest.

### 2. REIMBURSE PROXY SOLICITATION EXPENSES

Items to provide reimbursement for dissidents waging a proxy contest are made on a **case-by-case** basis. If the item is on ballot during a proxy contest, the item will be referred to SERS' Chief Investment Officer for internal review.

If the proposal is not on ballot during a proxy contest, SERS will generally vote **for** shareholder proposals calling for the reimbursement of reasonable costs incurred in connection with nominating one or more candidates in a contested election where the following apply:

- The election of fewer than 50% of the directors to be elected is contested;
- One or more of the dissident's candidates is elected;
- Shareholders are not permitted to cumulate their votes for directors; and
- The election occurred, and the expenses were incurred, after the adoption of this bylaw.

## D. Auditors

### 1. RATIFYING AUDITORS

The public's trust that audited financial statements provide an accurate picture of the company's finances is essential for the confidence that the capital markets require. While the Sarbanes-Oxley Act reduces some auditor conflict of interest situations, certain legally permissible services could still raise the potential for conflicts and compromise the impartiality of auditors. Public accounting firms should limit their services to performing audits and providing closely related services that do not put them in an advocacy position.

SERS will generally vote **for** management proposals to ratify auditors, unless:

- There is reason to believe the auditing firm has become complacent in its duties;
- An auditor has a financial interest in or association with the company, and is therefore not independent;
- There is reason to believe that the independent auditor has rendered an opinion that is neither accurate nor indicative of the company's financial position; and/or
- Fees for non-audit services are excessive.

SERS will vote **against** auditors and/or withhold votes from Audit Committee members if non-audit/other fees charged by the auditor are greater than the aggregated audit fees, audit-related fees, and permissible tax-related fees charged.

**Note:** Audit fees cover the performance of statutory audits, comfort letters, attest services, consents, and review of company filings with the SEC.

Audit-related fees cover the performance of employee benefit plan audits, due diligence related to mergers and acquisitions ("M&A"), audits in connection with acquisitions, internal control reviews, and consultation on financial accounting and reporting standards.

Tax-related fees cover the performance of tax compliance (tax returns, claims for refunds and tax payment planning) and tax consultation and planning (assistance with tax audits and appeals, tax advice relating to M&A, employee benefit plans and requests for rulings or technical advice from taxing authorities).

### 2. APPOINTMENT OF INTERNAL STATUTORY AUDITORS (JAPAN)

Japanese companies routinely seek approval of independent auditors as required by law. However, most companies are appointing internal auditors that are strongly affiliated, such as retired executives of the company or individuals from the company's main bank. These appointments may meet the letter of the law, but ignore its spirit.

SERS will generally vote **for** the appointment or reelection of statutory auditors, unless:

- There are serious concerns about the statutory reports presented or the audit procedures used;
- Questions or concerns exist regarding any of the statutory auditors being appointed; and/or
- The auditors have previously served the company in an executive capacity or can otherwise be considered affiliated with the company; and/or
- The nominee attended less than 75% of meetings of the board of directors or board of statutory auditors held the previous year without a valid reason.

### 3. INDEMNIFICATION OF AUDITORS

Companies should not agree to limit the liability of outside auditors. SERS will generally vote **against** proposals to indemnify such auditors.

### 4. AUDITOR INDEPENDENCE

SERS will vote on a **case-by-case** basis as to shareholder proposals asking companies to prohibit their auditors from engaging in non-audit services (or capping the level of non-audit services), taking into account:

- Whether the non-audit fees exceed the audit/tax-related fees, or are excessive in general; and/or
- Whether the company has policies and procedures in place to limit non-audit services or otherwise prevent auditor-related conflicts of interest.

### 5. AUDITOR FIRM ROTATION

SERS will evaluate on a **case-by-case** basis any shareholder proposals asking for auditor firm rotation, taking into account:

- The tenure of the company's current audit firm;
- The company's establishment and disclosure of a renewal process whereby the auditor is regularly evaluated for both audit quality and competitive fees;
- The length of the rotation period advocated in the proposal;
- The number of annual Audit Committee meetings held and the number of financial experts that serve on the Audit Committee; and/or
- Any significant audit-related issues.

### 6. REQUIRE AUDITOR FIRM RATIFICATION

SERS will generally vote **for** shareholder proposals requesting shareholders vote for audit firm ratification.

## E. Takeover Defenses

### 1. CLASSIFIED/STAGGERED BOARD

A classified or staggered board is one where all directors are not elected in the same year. This eliminates the possibility of removing entrenched management at any one annual election of directors.

SERS will vote **against** proposals to classify/stagger the board, and **for** proposals to repeal classified/staggered boards.

### 2. SHAREHOLDER ABILITY TO REMOVE DIRECTORS

SERS generally votes **against** proposals that provide that directors may be removed *only* for cause.

SERS generally votes **for** proposals to restore shareholder ability to remove directors with or without cause.

SERS generally votes **against** proposals that provide that only continuing directors may elect replacements to fill board vacancies.

SERS generally votes **for** proposals that permit shareholders to elect directors to fill board vacancies.

### 3. CUMULATIVE VOTING

SERS will generally vote **against** proposals to eliminate cumulative voting, and **for** proposals to restore or provide for cumulative voting, unless:

- The company has proxy access which allows shareholders to nominate directors to the company's ballot; and/or
- The company has adopted a majority vote standard, with a carve-out for plurality in situations where there are more nominees than seats and/or a director resignation policy is in place to address failed elections.

SERS will generally recommend a vote **for** proposals for cumulative voting at controlled companies (i.e., insider voting power exceeds 50%).

### 4. SHAREHOLDER'S ABILITY TO CALL SPECIAL MEETINGS OR ACT BY WRITTEN CONSENT

The ability to call special meetings or act by written consent gives shareholders more power in corporate governance. Both actions allow shareholders to take action prior to the next scheduled annual meeting.

SERS will vote **against** proposals to restrict or prohibit the shareholders' ability to call special meetings and/or act by written consent.

SERS will vote **for** proposals that remove restrictions on the right of shareholders to call special meetings and/or act by written consent.

## 5. SHAREHOLDER ABILITY TO ALTER THE SIZE OF THE BOARD

SERS generally votes **for** shareholder proposals that seek to alter the size of the board.

SERS generally votes **against** shareholder proposals that give management the ability to alter the size of the board without shareholder approval.

## 6. SHAREHOLDER RIGHTS PLANS (POISON PILLS)

SERS votes on a **case-by-case** basis on management proposals on poison pill ratification, focusing on the particular features of the shareholder rights plan. Such proposed plans should contain the following attributes:

- No lower than a 20% trigger, flip-in or flip-over;
- A term of no more than three years;
- No dead-hand, slow-hand, no-hand or similar feature that limits the ability of a future board to redeem the pill; and
- A shareholder redemption feature/qualifying offer clause (i.e., if the board refuses to redeem the pill 90 days after a qualifying offer is announced, 10 percent of the shares may call a special meeting or seek a written consent to vote on rescinding the pill).

In addition, the rationale for adopting the pill should be thoroughly explained by the company. In examining the request for the pill, SERS takes into consideration the company's existing governance structure, including without limitation: board independence, existing takeover defenses, and any problematic governance concerns.

SERS votes **against** proposals to adopt a poison pill for the stated purpose of protecting a company's net operating losses ("NOL") if the term of the pill would exceed the shorter of three years (or less) or the exhaustion of the NOL.

SERS votes on a **case-by-case** basis on management proposals for poison pill ratification if the term of the pill would be the shorter of three years (or less) and the exhaustion of the NOL, taking into account:

- The ownership threshold to transfer (NOL pills generally have a trigger slightly below 5 percent);
- The value of the NOL;
- Any other shareholder protection mechanisms (sunset provision, or commitment to cause the expiration of the pill upon exhaustion or expiration of NOL);
- The company's existing governance structure including without limitation: board independence, existing takeover defenses, track record of responsiveness to shareholders, and any other problematic governance concerns; and/or
- Any other factors that may be applicable.

SERS generally votes **for** shareholder proposals that ask a company to submit its poison pill for shareholder ratification. However, SERS will also consider:

- If the proposal is poorly targeted (i.e., the company does not currently have a poison pill in place);
- If the company currently has a policy in place that addresses the proponent's concerns (i.e., it must submit any future pills to shareholder vote within 12 months of adopting it); and/or
- If there is a shareholder approved poison pill in place.

SERS reviews on a **case-by-case** basis shareholder proposals to redeem a company's poison pill.

## 7. FAIR PRICE PROVISION

Fair price provisions allow management, without shareholder or board approval, to set price requirements that a potential bidder would need to satisfy in order to consummate a merger. These targets usually make the cost of acquisition prohibitively expensive. The fair price provisions usually require a supermajority vote to gain relief from the fair price provision.

SERS will vote **for** proposals to lower the shareholder vote requirement to obtain relief from a fair price provision.

SERS will vote **against** proposals to implement fair price provisions.

## 8. GREENMAIL

Greenmail payments are targeted share repurchases by management from individuals or groups seeking control of the company. As only the hostile party receives payment, usually at a substantial premium over the market value of its shares, the practice discriminates against all other shareholders. Greenmail payments have become a rare practice.

SERS will generally vote **for** proposals to adopt anti-greenmail charter or bylaw amendments, or otherwise restrict a company's ability to make greenmail payments.

SERS will review on a **case-by-case** basis anti-greenmail proposals when they are bundled with other charter or bylaw amendment proposals.

## 9. UNEQUAL VOTING RIGHTS

SERS believes in the one share/one vote philosophy that treats all shareholders of common equity equally.

SERS will vote **against** any proposals to authorize or issue shares with unequal voting privileges, taking into account market best practice, listing standards, and local corporate governance codes.

## 10. DUAL CLASS STOCK

As stated above, SERS believes in the one share/one vote philosophy that treats all shareholders of common equity equally.

SERS will generally vote **against** proposals to create a new class of common stock with superior voting rights.

SERS will generally vote **against** dual class exchange offers.

SERS will generally vote **against** dual class recapitalizations.

SERS will generally vote **for** resolutions that seek to maintain or convert to a one-share/one-vote capital structure.

**Note:** SERS will generally vote **for** proposals to create a new class of nonvoting or sub-voting common stock if it is (i) intended for financing purposes with minimal or no dilution to current

shareholders, and (ii) not designed to preserve the voting power of an insider or significant shareholder.

#### **11. SUPERMAJORITY SHAREHOLDER VOTE REQUIREMENT TO AMEND THE CHARTER OR BYLAWS**

A supermajority refers to a shareholder approval rate greater than 50% to pass proposals, and is used by management to make changes of control at the company harder to implement.

SERS will generally vote **against** management proposals to require a supermajority shareholder vote to approve charter and bylaw amendments.

SERS will generally vote **for** shareholder proposals to lower supermajority shareholder vote requirements for charter and bylaw amendments.

#### **12. SUPERMAJORITY SHAREHOLDER VOTE REQUIREMENT TO APPROVE MERGERS**

A majority vote of common shares should be all that is required to approve major corporate decisions concerning the sale or pledge of corporate assets that would have a material impact on shareholder value.

SERS will generally vote **against** management proposals to require a supermajority shareholder vote to approve mergers and other significant business combinations.

SERS will generally vote **for** shareholder proposals to lower supermajority shareholder vote requirements for mergers and other significant business combinations.

#### **13. TARGETED SHARE ("WHITE SQUIRE") PLACEMENTS**

Targeted share placements are the issuance of voting shares, warrants, preferred stock or other securities convertible into voting stock to one person or group.

SERS will vote **for** proposals requiring shareholder approval of targeted share placements.

#### **14. RENEWAL OF PARTIAL TAKEOVER PROVISIONS (AUSTRALIA)**

Australian law allows companies to introduce into their articles a provision to protect shareholders from partial takeover offers, to be renewed by shareholders every three years. If a partial takeover of the company is announced, directors are required to convene a shareholder meeting at least 15 days before the closing of the offer to seek approval. If shareholders reject the resolution, the offer is considered withdrawn under company law and the company can refuse to register the shares tendered to the offer. This provision provides protection for minority shareholders by giving them ultimate decision-making authority based on their own interests, not the interests of directors or outside parties. SERS will vote **for** consulting shareholders on partial takeover offers.

## F. Miscellaneous Corporate Governance Provisions

### 1. ARTICLE AMENDMENTS

SERS will review on a **case-by-case** basis all proposals seeking amendments to the articles of association.

SERS will generally vote **for** article amendments if:

- Shareholder rights are protected;
- There is negligible or positive impact on shareholder value;
- Management provides adequate justification for the amendments; and/or
- The company is required to do so by law (if applicable).

### 2. EXPAND BUSINESS ACTIVITIES

SERS will generally vote **for** resolutions to expand business activities, unless it believes the new business takes the company into risky areas.

### 3. AMEND QUORUM REQUIREMENTS

SERS will generally vote **against** amendments to lower the quorum requirement, unless SERS believes the (i) proposed change is consistent with market norms, (ii) company's reasons for the change is in line with shareholders' interests, and (iii) company's ownership structure would not hamper broad shareholder participation. Companies that have a substantial shareholder or shareholder group should set their quorum requirement well above the percentage of shares owned by such shareholder or shareholder group. Quorum requirements are intended to ensure that a broad range of shareholders are represented at meetings.

### 4. LOWER DISCLOSURE THRESHOLD FOR STOCK OWNERSHIP (UK AND FRANCE)

Companies in the United Kingdom and France have the ability to lower the percentage of stock ownership below the legal limit at which shareholders are required to disclose ownership. In France the legal limit is five percent ownership, while in the United Kingdom it's three percent. Companies in both countries often lower the required percentage to a fraction of one percent. If a shareholder fails to comply with a disclosure request, the company could suspend voting rights, withhold dividends, and refuse to register transfers of shares.

SERS will vote **against** these proposals since lower disclosure levels do not add substantially to shareholders' interests, and often are a pretext for an anti-takeover defense.

### 5. CONFIDENTIAL VOTING

A company that does not have a secret ballot provision allows management to see the votes of the shareholders prior to the meeting, thus giving management an unfair advantage. SERS' preference is for automatic and permanent confidentiality in corporate voting.

SERS will vote **for** proposals that:

- Establish confidential voting;
- Use independent vote tabulators; and/or
- Require independent inspectors of elections.

SERS will review confidential vote tally proposals on a **case-by-case** basis, taking into account:

- Whether the policy allows the company to monitor the number of votes cast for purposes of achieving a quorum or to conduct solicitations for other proper purposes; and/or
- Whether the enhanced confidential voting requirement applies to contested elections of directors or to contested proxy solicitations, which would put the company at a disadvantage relative to dissidents.

## 6. PROXY ACCESS

The board should not have the ability to prevent a shareholder proposal from appearing in the proxy statement for arbitrary reasons.

SERS will generally vote **for** management and shareholder proposals for proxy access with the following provisions:

- Ownership threshold: maximum requirement not more than three percent (3%) of the voting power;
- Ownership duration: maximum requirement not longer than three (3) years of continuous ownership for each member of the nominating group;
- Aggregation: minimal or no limits on the number of shareholders permitted to form a nominating group; and
- Cap: cap on nominees of generally twenty-five percent (25%) of the board.

## 7. BUNDLED PROPOSALS

SERS is philosophically opposed to bundled proposals, especially when shareholder rights to call special meetings or act by written consent are curtailed.

SERS generally votes **against** the practice of bundled proposals, unless issues that are beneficial to shareholders outweigh those that are not.

## 8. SHAREHOLDER ADVISORY COMMITTEES

Proposals to establish a shareholder advisory committee will be reviewed on a **case-by-case** basis.

## 9. OTHER BUSINESS

SERS will generally vote **against** proposals that seek to bring forth other business matters, as these issues cannot be known.

## 10. ADJOURN MEETING

All directors should attend the annual shareholders' meeting and be available, when requested by the chair, to answer shareholder questions. Polls should remain open at shareholder meetings until all agenda items have been discussed.

Generally, SERS will vote **against** proposals to provide management with the authority to adjourn an annual or special meeting absent compelling reasons to support the proposal. SERS will vote **for** proposals that relate specifically to soliciting votes for a merger or transaction if SERS supports that particular merger or transaction. SERS will vote **against** proposals if the wording is too vague or if the proposal includes "other business."

## 11. STAKEHOLDER PROVISIONS

Stakeholder provisions allow the board to consider the interest of stakeholders in making decisions regarding corporate matters, particularly takeovers. Some states have such provisions incorporated into their anti-takeover laws. SERS believes that the board has a responsibility to consider those interests as part of its oversight responsibilities, but not at the expense of shareholder rights.

SERS will vote **for** proposals repealing stakeholder interests, and for opting out of stakeholder laws.

SERS will vote **against** proposals requiring the board to consider stakeholder interests.

## 12. DISCLOSURE

SERS generally votes **for** disclosure of corporate information where the cost of providing the information is not burdensome.

However, SERS will vote **against** disclosure when it would compromise trade secrets, proprietary information, or information on a company's military contracts.

## 13. ANNUAL MEETING LOCATION

SERS will generally vote **against** proposals to hold the meeting somewhere other than where management has chosen to hold the meeting.

However, corporations should make shareholders' expense and convenience primary criteria when selecting the time and location of shareholder meetings.

## 14. GOVERNANCE RELATED SHAREHOLDER PROPOSALS

SERS will generally vote on a **case-by-case** basis on other governance-related shareholder proposals, taking into account SERS' existing approach on the issue(s) and market best practices.

## G. Capital Structure

### 1. COMMON STOCK AUTHORIZATION

#### U.S. Companies

SERS will generally vote **for** proposals to increase the number of authorized common shares where the primary purpose of the increase is to issue shares in connection with a transaction on the same ballot that warrants support.

SERS will generally vote **against** such proposals at companies with more than one class of common stock where they are intended to increase the number of authorized shares of the class that has superior voting rights.

SERS will generally vote **against** proposals to increase the number of authorized common shares if a vote for a reverse stock split on the same ballot is warranted, despite the fact that the authorized shares would not be reduced proportionally.

SERS will vote **case-by-case** on all other proposals to increase the number of shares of common stock authorized for issuance. SERS will take into account company-specific factors that include, at a minimum, the following:

- Past Board Performance:
  - The company's use of authorized shares during the last three years;
- The Current Request:
  - Disclosure in the proxy statement of the specific purpose of the proposed increase;
  - Disclosure in the proxy statement of specific and severe risks to shareholders of not approving the request; and/or
  - The dilutive impact of the request as determined by an allowable increase (typically 100 percent of existing authorized shares) that reflects the company's need for shares and total shareholder returns.

#### Non-U.S. Companies

Companies may request increases in authorized capital for general financing flexibility or to provide for a specific purpose. Companies need an adequate buffer of unissued capital in order to take advantage of different business opportunities, and thus often request increases in authorized capital for no specific purpose other than to retain this flexibility.

SERS will vote **for** nonspecific proposals to increase authorized capital up to 100 percent over the current authorization unless the increase would leave the company with less than 30 percent of its new authorization outstanding.

SERS will also vote **for** specific proposals to increase capital, unless the specific purpose for the increase does not meet SERS' guidelines, or the increase would leave the company with less than 30 percent of its new authorized stock outstanding after adjusting for all proposed issuances.

SERS will generally vote **for** compensation plans that have a significant stock-based portion of the total compensation package, and are linked to the performance of long-term shareholder interests.

SERS will vote **against** proposals to adopt unlimited capital authorizations.

## 2. CAPITAL ISSUANCE REQUESTS

General issuance requests under both authorized and conditional capital systems allow companies to issue shares to raise funds for general financing purposes. Issuances can be carried out with or without preemptive rights. Corporate law in many countries recognizes preemptive rights and requires shareholder approval for the disapplication of such rights.

SERS will vote **for** general issuance requests with preemptive rights for up to 100 percent of a company's outstanding capital, as this generally provides the company with sufficient financing to meet most contingencies.

SERS will vote **for** general issuance requests without preemptive rights for up to 20 percent of a company's outstanding capital.

SERS will vote **against** requests that allow excessive discounts, or refresh issuance authority, without shareholder approval.

Specific issuance requests will be judged on their individual merits on a **case-by-case** basis taking into account market best practices.

## 3. SHARE REPURCHASE PROGRAMS

SERS will vote **for** proposals to repurchase a company's stock up to a designated amount over a specified period of time. SERS favors open market repurchase plans that give all shareholders a right to participate.

## 4. REISSUANCE OF REPURCHASED SHARES

SERS will generally vote **for** requests to reissue any repurchased shares, unless there is reason to believe that such authority would be open to possible abuse, or there is clear evidence of abuse of such authority in the past.

## 5. STOCK SPLITS

SERS will generally vote **for** stock splits if management provides reasonable justification for the proposed split.

## 6. REVERSE STOCK SPLITS

SERS will review management proposals to implement a reverse stock split on a **case-by-case** basis. SERS will generally support management proposals to implement a reverse stock split to avoid delisting, or when the number of authorized shares will be proportionately reduced.

## 7. BLANK CHECK PREFERRED STOCK

Blank check preferred stock is a class of preferred stock that the board can issue at its discretion with respect to voting, conversion, distribution, and other rights given to shareholders. This type of discretionary issuance of preferred stock can be used by the board in a takeover defense.

SERS will vote **against** proposals authorizing the creation of new classes of preferred stock with unspecified voting, dividend distribution, and other rights ("blank check" preferred stock).

SERS will vote **for** proposals to create "declawed" blank check preferred stock (which could not be used by the board as a takeover defense).

SERS will vote **for** proposals to authorize preferred stock in cases where the company specifies the voting, dividend, and other rights of such stock, and the terms of the preferred stock appear reasonable.

SERS will vote **against** proposals to increase the number of blank check preferred stock authorized for issuance when no shares have been issued or reserved for a specific purpose.

SERS will vote on a **case-by-case** basis on proposals to increase the number of blank check preferred shares after analyzing past board performance and the current request, including the purpose and dilutive impact of the increase.

## **8. SHAREHOLDER PROPOSALS REGARDING BLANK CHECK PREFERRED STOCK**

SERS will vote **for** shareholder proposals to have blank check preferred stock placements submitted for shareholder ratification, other than those shares issued for the purpose of raising capital or making acquisitions in the normal course of business.

## **9. ADJUST PAR VALUE OF COMMON STOCK**

SERS will generally vote **for** management proposals to reduce the par value of common stock, unless the action is being taken to facilitate an anti-takeover device or some other negative corporate governance action.

SERS will generally vote **for** management proposals to eliminate the par value of common stock.

## **10. CONVERSION OF SECURITIES/CONVERTIBLE DEBT ISSUANCE REQUESTS**

SERS will generally vote **for** the creation/issuance of convertible debt instruments as long as the maximum number of common shares that could be issued upon conversion meets SERS' guidelines on equity issuance requests as articulated herein.

However, SERS will vote on a **case-by-case** basis regarding the conversion of securities, taking into account (i) the dilution to existing shares, (ii) the conversion price relative to market value, (iii) financial issues, (iv) control issues, (v) termination penalties, and (vi) any conflicts of interest.

SERS will vote **for** the conversion of securities if it is expected that the company will be subject to onerous penalties, or will be forced to file for bankruptcy, if the transaction is not approved.

## **11. DEBT ISSUANCE REQUESTS (NON-CONVERTIBLE)/INCREASE IN BORROWING POWERS**

When evaluating a debt issuance request, the issuing company's present financial situation is examined. The main factor for analysis is the company's current debt-to-equity ratio or gearing level. A high gearing level may incline markets and financial analysts to downgrade the company's bond rating, increasing its investment risk factor in the process. A gearing level of up to 100% is considered acceptable.

SERS will vote **for** debt issuances for companies when the gearing level is between zero and 100 percent.

In cases where the issuance of debt will result in a gearing level being greater than 100%, SERS will consider these proposals based on the normal market practice.

SERS will generally vote **for** proposals to approve increases in a company's borrowing powers after taking into account (i) management's stated need for the increase, (ii) the size of the increase, and (iii) the company's current gearing level. Large increases in borrowing powers can sometimes result in dangerously high debt-to-equity ratios that could harm shareholder value. If an increase is excessive without sufficient justification, and/or a company already has an exceptionally high gearing level compared to its industry, SERS will typically vote **against** the request.

## 12. DEBT RESTRUCTURING

SERS will review on a **case-by-case** basis proposals to increase common and/or preferred shares, and/or to issue shares, as part of a debt-restructuring plan, considering the following factors:

- Dilution: How much will the ownership interests of existing shareholders be reduced, and how extreme will the dilution be to any future earnings?
- Change in Control: Will the transaction result in a change in control of the company?
- Bankruptcy: Is the threat of bankruptcy (which would result in severe losses in shareholder value) the main factor driving the debt restructuring?
- Terms of the offer: What is the discount/premium in purchase price to investors, including any fairness opinion, termination penalties, and/or exit strategy?
- Financial issues: What is the company's financial situation (e.g., degree of need for capital; use of proceeds), and what is the effect of the financing on the company's cost of capital?
- Alternatives: What are management's efforts to pursue other alternatives?

SERS will generally vote **for** proposals that facilitate debt restructurings unless there are clear signs of self-dealing or other abuses.

## 13. PLEDGING OF ASSETS FOR DEBT

SERS will vote on a **case-by-case** basis on proposals to approve the pledging of assets for debt, taking into account the terms of the proposed debt issuance and the company's overall debt level.

## 14. FINANCING PLANS

SERS will generally vote **for** the adoption of financing plans if they are in the best economic interests of shareholders.

## 15. CONTROL AND PROFIT TRANSFER AGREEMENTS

SERS will generally vote **for** proposals to approve control and profit transfer agreements between a parent company and its subsidiaries.

## 16. CAPITALIZATION OF RESERVES

SERS will vote **for** proposals to capitalize the company's reserves for bonus issues of shares or to increase the par value of shares.

## 17. DEFENSIVE USE OF AUTHORIZED SHARE ISSUANCES

SERS will generally vote **against** management requests to issue shares in the event of a takeover offer or exchange bid for the company's shares.

## 18. REDUCTION OF CAPITAL

SERS will generally vote **for** proposals to reduce capital for routine accounting purposes, unless the terms are unfavorable to shareholders.

SERS will vote on a **case-by-case** basis on proposals to reduce capital in connection with corporate restructuring, taking into account the company's situation and the future prospects for shareholders.

## 19. GOLDEN SHARES

Recently privatized companies around the world often include in their share structure a golden share held by their respective governments. These shares often carry special voting rights or the power of automatic veto over specific proposals. Golden shares are most common among former state-owned companies or politically sensitive industries such as utilities, railways, and airlines.

While the introduction of golden shares is not a desirable governance practice, SERS recognizes the political importance certain companies hold for governments, and reviews proposals for the introduction or amendment of government shares on a **case-by-case** basis.

## H. Executive and Director Compensation

SERS will generally vote **for** compensation plans that have a significant stock-based portion of the total package, and are linked to the performance of long-term shareholder interests.

### 1. EQUITY BASED COMPENSATION PLANS

#### U.S. COMPANIES

SERS will generally vote on a **case-by-case** basis on certain equity-based compensation plans<sup>1</sup> depending on a combination of certain plan features and equity grant practices, where positive factors may counterbalance negative factors, and vice versa, as evaluated using an "equity plan scorecard" (EPSC) approach utilizing the following three pillars:

- Plan Cost: The total estimated cost of the company's equity plans relative to industry/market cap peers, measured by the company's estimated Shareholder Value Transfer (SVT) in relation to peers when considering both:

- SVT based on new shares requested plus shares remaining for future grants, plus outstanding unvested/unexercised grants; and
- SVT based only on new shares requested plus shares remaining for future grants.

- Plan Features:

- Automatic single-triggered award vesting upon a change in control (CIC);
- Discretionary vesting authority;
- Liberal share recycling on various award types;
- Lack of minimum vesting period for grants made under the plan.

- Grant Practices:

- The company's three year burn rate relative to its industry/market cap peers;
- Vesting requirements in most recent CEO equity grants (three year look-back);
- The estimated duration of the plan (based on the sum of shares remaining available and the new shares requested, divided by the average annual shares granted in the prior three years);
- The proportion of the CEO's most recent equity grants/awards subject to performance conditions;
- Whether the company maintains a claw-back policy;
- Whether the company has established post exercise/vesting share-holding requirements.

SERS will generally vote **against** the compensation plan proposal if the combination of above factors indicates that the plan is not, overall, in the shareholders' best interests, or if any of the following egregious factors apply:

- Awards may vest in connection with a liberal change-of-control definition;
- The plan would permit repricing or cash buyout of underwater options without shareholder approval (either by expressly permitting it for NYSE and Nasdaq listed companies, or for non-listed companies, by not prohibiting it when the company has a history of repricing);
- The plan is a vehicle for problematic pay practices or a significant pay-for-performance disconnect under certain circumstances; and/or

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<sup>1</sup> Proposals evaluated under Institutional Shareholder Services Inc.'s Equity Plan Scorecard policy generally include those to approve or amend (1) stock option plans, (2) restricted stock plans, and (3) omnibus stock incentive plans, for employees and/or directors.

- Any other plan features are determined to have a significant negative impact on shareholder interests.

## NON-U.S. COMPANIES

SERS favors the use of stock options to align management and shareholder interests. However, some stock options are adversarial to shareholder interests, and will be opposed by SERS based on the following factors:

- Total dilution of the plan:
  - Shares available under all compensation plans should be no more than 5% of the issued capital at the time of approval for mature companies, and no more than 10% of the issued capital at the time of approval for growth companies;
  - Plans at mature companies with dilution levels of up to 10% may be supported if the plan includes other position features such as challenging performance criteria or premium-priced options;
- Exercise price:
  - SERS prefers that options be priced at not less than 100% of the shares' fair market value on the date of grant;
  - In the absence of performance criteria, SERS opposes grants of discounted options, including restricted stock;
- Plan administration: Administration of plans should be in the hands of directors who are unable to participate in the plan. Plans that allow non-executive directors to participate should prohibit them from having any influence or discretion on individual grants; instead, an automatic system of grants should be introduced with fixed annual grants at market prices on a fixed date;
- Vesting Periods: SERS prefers a minimum three year vesting period;
- Repricing: SERS opposes plans that include option repricing when the exercise price is reduced in response to a dropping share price;
- Reloading Options: SERS opposes the reloading of options when an existing grant expires, as this eliminates the risk of exercising options;
- Converting option grants into cash: Stock Appreciation Rights permit the holder to receive the difference between option price and market value in cash, without exercising the option. Pyramiding permits payment for stock options with the conversion of previously owned shares that have appreciated. Both practices are cash compensation plans disguised as stock-linked compensation.
- Market best practices: SERS will vote **against** option plans that do not incorporate criteria that is standard market practice, such as the use of performance criteria.

SERS will vote **against** loans to officers to purchase stock, especially at below-market interest rates.

SERS will vote **for** specific stock award plans to officers, but opposes discretionary awards.

In the UK, whether the terms of a compensation plan are to be satisfied by the issuance of new shares or through the use of treasury shares, the maximum commitment of the aggregate awards under all of the company's plans should not exceed 10% of issued ordinary capital over a rolling 10-year period for broad-based plans. Within these limits, awards for discretionary plans should not exceed 5% for a rolling 10-year period.

In general, SERS prefers to see the full text of the proposed compensation plan, or a summary of the plan's key terms, with information on the plan's dilution, exercise price/presence of discounts, administration and participation, types of awards used, vesting provisions, and performance criteria.

However, in many markets, especially where companies are only beginning to introduce stock-based compensation, information on key plan terms can be quite limited. Until disclosure standards improve in these markets, SERS believes that it would be counterproductive to oppose all plans in a given country on this basis. Still, some basic parameters are necessary in order for SERS to consider supporting a compensation plan. At a minimum, companies should disclose information on the maximum potential dilution of a plan, and information concerning the exercise price. If a plan meets SERS' guidelines on these two points, SERS will generally support the plan. For markets where certain plan information is regularly disclosed, and a company has failed to provide this information to shareholders, SERS will generally vote **against** the plan on the basis of substandard disclosure.

## 2. REMUNERATION REPORT OR POLICY/MANAGEMENT ADVISORY VOTE ON EXECUTIVE COMPENSATION

SERS will vote **for** proposals that require annual advisory shareholder votes on the compensation of senior executives.

### U.S. COMPANIES

SERS will vote **against** management say-on-pay (MSOP) proposals, **against/withhold** on compensation committee member (or, in rare cases where the full board is deemed responsible, all directors including the CEO), and/or **against** an equity-based incentive plan proposal if:

- There is a misalignment between CEO pay and company performance (pay for performance);
- The company maintains problematic pay practices; and/or
- The board exhibits poor communication and responsiveness to shareholders.

For externally-managed issuers (EMIs), SERS will generally vote **against** the say-on-pay proposal when insufficient compensation disclosure precludes a reasonable assessment of pay programs and practices applicable to the EMI's executives.

### Voting Alternatives

In general, the MSOP ballot item is the primary focus of voting on executive pay practices. Shareholder dissatisfaction with a company's compensation practices can be expressed by voting against MSOP proposals rather than withholding or voting against the compensation committee. However, if there is no MSOP proposal on the ballot, then the negative vote will apply to members of the compensation committee. In addition, in egregious cases, or if the board fails to respond to concerns raised by a prior MSOP proposal, then SERS will vote **against/withhold** on compensation committee members (or, if the full board is deemed accountable, all directors). If the negative factors involve equity-based compensation, then SERS will vote **against** an equity-based plan proposal presented for shareholder approval.

### NON-U.S. COMPANIES

SERS will take market practice into account when considering the remuneration reports or policies, and vote **for** proposals where the company has acted within market best practice. That said, such best compensation practices across all markets should be consistent with the following principles:

- Provide shareholders with clear, comprehensive compensation disclosures;
- Maintain appropriate pay-for-performance alignment with emphasis on long-term shareholder value;
- Avoid arrangements that risk "pay for failure";
- Maintain an independent and effective compensation committee; and
- Avoid inappropriate pay to directors.

### 3. OBRA-RELATED COMPENSATION PROPOSALS (U.S. COMPANIES ONLY)

SERS will generally vote **for** proposals to approve or amend executive incentive bonus plans if the proposal:

- Is only to include administrative features;
- Places a cap on the annual grants any one participant may receive to comply with the provisions of Section 162(m) of the Omnibus Budget Reconciliation Act (OBRA);
- Adds performance goals to existing compensation plans to comply with the provisions of Section 162(m) unless they are clearly inappropriate; and/or
- Covers cash or cash and stock bonus plans that are submitted to shareholders for the purpose of exempting compensation from taxes under the provisions of Section 162(m) if no increase in shares is requested.

SERS will vote **against** such proposals if:

- The compensation committee does not fully consist of independent outsiders, per SERS' director classification;
- The plan contains excessive problematic provisions;
- In addition to seeking Section 162(m) tax treatment, the amendment may cause the transfer of additional shareholder value to employees (e.g., by requesting additional shares, extending the option term, or expanding the pool of plan participants). In such cases, SERS will evaluate the SVT in comparison with the company's allowable cap; and/or
- A company is presenting the plan to shareholders for Section 162(m) favorable tax treatment for the first time after the company's initial public offering (IPO). In such cases, SERS will perform a full equity plan analysis, including consideration of total SVT, burn rate (if applicable), repricing, and liberal CIC. Other factors such as pay-for-performance or problematic pay practices as related to MSOP may be considered (where applicable).

### 4. QUALIFIED AND NON-QUALIFIED EMPLOYEE STOCK PURCHASE PLANS

SERS will vote **against** qualified employee stock purchase plans where either any of the following apply:

- Purchase price is less than 85% of fair market value;
- Offering period is greater than 27 months; or
- The number of shares allocated to the plan is more than 10% of the outstanding shares.

SERS will vote **for** non-qualified employee stock purchase plans with all of the following features:

- Broad-based participation;
- Limits on employee contribution;
- Company matching contribution up to 25% of employee's contribution (an effective 20% discount off market value); and
- No discount on the stock price on the date of purchase (due to company matching contribution).

### 5. SHAREHOLDER PROPOSALS TO LIMIT EXECUTIVE AND/OR DIRECTOR PAY

SERS will vote **for** shareholder proposals that seek additional disclosure of executive and/or director pay information, provided the information requested is relevant to shareholders' needs, would not put the company at a competitive disadvantage relative to its industry, and is not unduly burdensome to the company.

SERS will generally vote **against** shareholder proposals seeking to set absolute levels on executive and/or director compensation, or otherwise dictate the amount or form of such compensation.

SERS will generally vote **against** shareholder proposals seeking to eliminate stock options or any other equity grants to employees or directors.

SERS will generally vote **against** shareholder proposals requiring director fees be paid in stock only. SERS will review on a **case-by-case** basis all other shareholder proposals that seek to limit executive and/or director pay, taking into account (i) the details of the proposal, (ii) company performance, (iii) pay level versus peers, (iv) pay level versus industry, and (v) long-term corporate outlook.

## 6. GOLDEN AND TIN PARACHUTES

SERS will generally vote **for** shareholder proposals to have golden and tin parachutes submitted for shareholder ratification. A “golden parachute” is a term used for a special compensation arrangement between a company and its senior executives in the event the company is acquired or if the executive is terminated. The term “tin parachute” refers to similar compensation arrangements granted to all company employees below the executive level.

SERS will review on a **case-by-case** basis all management proposals to ratify or cancel golden or tin parachutes. An acceptable parachute should include, but is not limited to, the following:

- The triggering mechanism should be beyond the control of management;
- The amount should not exceed three times base amount (defined as the average annual taxable W-2 compensation during the five years prior to the year in which the change of control occurs); and
- Change-in-control payments should be double-triggered (i.e., (1) after a change in control has taken place, and (2) termination of the executive as a result of the change).

SERS will vote on a **case-by-case** basis on say-on-golden-parachute proposals, including consideration of existing change-in-control arrangements maintained with named executive officers rather than focusing primarily on new or extended arrangements.

Features that may result in an adverse vote by SERS include one or more of the following, depending on the number, magnitude, and/or timing of issue(s):

- Single-trigger or modified-single-trigger cash severance;
- Single-trigger acceleration of unvested equity awards;
- Excessive cash severance (greater than 3x base salary and bonus);
- Excise tax gross-ups triggered and payable (as opposed to a provision to provide excise tax gross-ups);
- Excessive golden parachute payments (on an absolute basis or as a percentage of transaction equity value);
- Recent amendments that incorporate any problematic features (such as those above) or recent actions (such as extraordinary equity grants) that may make packages so attractive as to influence merger agreements that may not be in the best interests of shareholders; and/or
- The company's assertion that a proposed transaction is conditioned on shareholder approval of the golden parachute advisory vote.

**Note:** Recent amendments to a company's parachute policies that incorporate problematic features will tend to carry more weight on the overall analysis. However, the presence of multiple legacy problematic features will also be closely scrutinized.

In cases where the golden parachute vote is incorporated into a company's advisory vote on compensation (MSOP), SERS will evaluate the say-on-pay proposal in accordance with these guidelines, which may give higher weight to that component of the overall evaluation.

## **7. DIRECTOR REMUNERATION**

SERS will vote **for** proposals to award cash fees to non-executive directors, unless the amounts are excessive relative to other companies in the country or industry. When the value of awarded shares is significantly greater than the cash compensation that the directors receive, SERS will vote **against** such proposals.

SERS will vote **against** proposals that require director fees to be paid only in stock.

SERS will generally vote **for** proposals to compensate non-employee directors in stock in lieu of cash when the annual level compensation in stock is comparable to the annual level of cash compensation. When the value of awarded shares is significantly greater than the cash compensation that the directors receive, SERS will vote **against** such proposals.

SERS will vote **for** proposals that eliminate non-employee director pension plans.

## **8. RETIREMENT BONUSES FOR DIRECTORS AND STATUTORY AUDITORS**

SERS will generally vote **against** the payment of retirement bonuses to directors and statutory auditors when one or more of the individuals to whom the grants are being proposed has not served in an executive capacity for the company for at least three years. SERS will also generally vote **against** payment of retirement bonuses to any directors or statutory auditors who have been designated by the company as independent. Retirement bonus proposals are all-or-nothing, meaning that split votes against individual payments cannot be made. If any one individual does not meet the independence criteria, SERS will generally vote **against** the entire bundled item.

## **9. 401(K) EMPLOYEE BENEFIT PLANS/EMPLOYEE STOCK OWNERSHIP PLANS (ESOP)**

SERS will vote **for** proposals to implement 401(k) plans for employees.

SERS will vote **for** a proposal seeking approval to implement an ESOP, unless the plan is part of an anti-takeover defense.

## **10. PERFORMANCE-BASED EQUITY COMPENSATION**

The use of performance-based compensation should provide a better linkage of management's interests with those of the company's shareholders. Compensation policies should have a long-term focus that corresponds with the company's long-term goals.

SERS will generally favor shareholder proposals advocating the use of performance-based equity awards (indexed-options, premium-priced options, performance-vested awards).

SERS will generally vote **for** shareholder proposals advocating the use of performance-based equity awards, unless the company demonstrates that it is using a "substantial" portion of performance-based awards for its top executives.

## 11. HOLDING PERIODS

Key executives and directors should be encouraged to obtain and hold a significant amount of the company's stock as further incentive to operate the company in a manner that maximizes its value for all shareholders. SERS will generally vote **for** shareholder proposals asking companies to adopt full tenure holding periods for stock or other equity granted for their executives. The percentage/ratio of net shares required to be retained, and minimum holding periods for equity, will be evaluated. Holding periods for senior executives and directors should generally not be less than the holding period for other employees under 401(k) or similar retirement plans.

## 12. FUTURE STOCK OPTION AWARDS

SERS will generally vote **against** shareholder proposals to ban future stock option grants to executives. SERS may consider supporting such shareholder proposals in situations where the company (i) is a serial repricer, (ii) has a huge "overhang", and/or (iii) has a highly dilutive, broad-based, and non-approved stock option plan and is not acting to correct the situation.

## 13. SUPPLEMENTAL RETIREMENT BENEFITS FOR EXECUTIVES

SERS will generally vote **for** proposals requiring the company to report on its executive retirement benefits (such as deferred compensation, split-dollar life insurance, supplemental executive retirement plans (SERPs), and pension benefits).

SERS will generally vote **for** shareholder proposals requesting to put extraordinary benefits contained in SERP agreements to a shareholder vote, unless the company's executive pension plans do not contain excessive benefits beyond what is offered under employee-wide plans.

## 14. PRE-ARRANGED TRADING PLANS (UNDER SEC RULE 10b5-1 PLANS)

SERS will generally vote **for** a shareholder proposal calling for certain principles regarding the use of prearranged trading plans (as permitted under SEC Rule 10b5-1) for corporate executives. These principles include:

- The adoption, amendment, or termination of a 10b5-1 Plan must be disclosed within two business days in a Form 8-K;
- An amendment or early termination of a 10b5-1 Plan is allowed only under extraordinary circumstances, as determined by the board;
- Ninety (90) days must elapse between the adoption or amendment of a 10b5-1 Plan, and initial trading under such plan;
- Reports on Form 4 must identify transactions made pursuant to a 10b5-1 Plan;
- An executive may not trade in company stock outside the 10b5-1 Plan; and/or
- Trades under a 10b5-1 Plan must be handled by a broker who does not handle other securities transactions for the executive seeking to trade under the plan.

## 15. OPTION EXCHANGE/REPRICING PROGRAMS

SERS will vote on a **case-by-case** basis on management proposals seeking approval to exchange/reprice options, taking into consideration the following factors:

- Historic trading patterns (i.e., whether the stock price is so volatile that the options are likely to be back "in-the-money" over the near term);

- Rationale for the repricing (i.e., whether the stock price decline was beyond management's control);
- Whether it was a value-for-value exchange;
- Whether surrendered stock options will be added back to the plan reserve;
- Whether the new option will vest immediately or after a black-out period);
- The term of the option should remain the same as that of the replaced option);
- The exercise price should be set at fair market or a premium to market; and/or
- Participants (i.e., executive officers and directors should be excluded).

## 16. COMPENSATION-RELATED SHAREHOLDER PROPOSALS

SERS will generally vote **for** shareholder proposals calling for companies to adopt a policy of not providing tax gross-up payments to corporate executives, except in situations where gross-ups are provided pursuant to a plan, policy or arrangement applicable to management employees of the company (such as a relocation of expatriate tax equalization policy).

SERS will generally vote **for** shareholder proposals calling for board compensation committees to develop and disclose a policy for (i) reviewing unearned bonus and incentive payments that were awarded to executive officers as a result of fraud, (ii) reviewing financial results that require restatement, and/or (iii) some other cause. Such a policy should require recovery or cancellation of any unearned awards to the extent that it is feasible and practical to do so.

SERS will generally vote **for** shareholder proposals calling for companies to adopt a policy on severance pay.

SERS will generally vote on a **case-by-case** basis on other compensation-related shareholder proposals, taking into account SERS' existing approach on the issue and market best practice.

## 17. MISCELLANEOUS COMPENSATION ISSUES

SERS will vote **for** pay-for-performance fees.

SERS will vote **against** loans to officers to purchase stock, especially at below-market interest rates.

SERS opposes discretionary equity awards to officers outside of existing equity compensation plans. SERS will vote on a **case-by-case** basis on plan-based equity grants to officers, based on the same criteria by which SERS evaluates equity compensation plans in general.

# I. Incorporation

## 1. VOTING ON STATE TAKEOVER STATUTES

Many states have statutory provisions that specifically discourage takeover activity. Many states allow a company to opt out of these anti-takeover laws.

SERS will vote **for** proposals to opt out of state anti-takeover statutes.

Subject to the caveat stated above, SERS will review on a **case-by-case** basis proposals to opt in or out of state takeover statutes (including control share acquisition statutes, control share cash-out statutes, freeze-out provisions, fair price provisions, stakeholder laws, poison pill endorsements, severance pay and labor contract provisions, anti-greenmail provisions, and disgorgement provisions), evaluating from the perspective of the statutes' effect on shareholders' rights.

## 2. REINCORPORATION

SERS votes on a **case-by-case** basis on management or shareholder proposals to change a company's state of incorporation, giving consideration to both financial and corporate governance concerns that include the following:

- Reasons for the proposed reincorporation;
- Governance provisions in the proposed new charter that differ from those in the existing charter; and/or
- Comparison of the corporation laws of the original state and the destination state.

SERS will vote **for** proposals to reincorporate in states that are more supportive to shareholder rights, and/or which are supported by compelling business reasons.

SERS will vote **against** proposals to reincorporate in states with tougher anti-takeover laws, or states that have poor corporate governance profiles.

SERS votes **for** reincorporation when economic factors outweigh any neutral or negative governance changes.

The issue of offshore reincorporation is complicated, primarily involving many issues other than purely corporate governance issues. First and foremost, reincorporation issues are fiduciary issues. Many companies will strive to take advantage of legal tax advantages in order to become more profitable. Often, a company pays taxes only on its U.S. earnings, and may be able to reduce or eliminate paying taxes on its foreign earnings by reincorporating. However, a secondary consequence of offshore reincorporation may be a diminution of shareholder rights. Therefore, while offshore reincorporation may be politically and socially undesirable, it may still be prudent from a fiduciary point of view.

SERS will evaluate on a **case-by case** basis shareholder proposals that seek to bar a company from relocating offshore.

SERS will evaluate on a **case-by-case** basis shareholder proposals requiring a company to reincorporate back to the United States from an offshore jurisdiction.

## J. Mergers and Corporate Restructurings

In voting proxies, SERS pays special attention to companies that are either headquartered or incorporated in Pennsylvania to ensure that the best interests of the Commonwealth (and SERS members who live in the Commonwealth) are taken into account. Any proxy votes related to mergers and acquisitions involving Pennsylvania-based companies, or proposals affecting the SERS board of directors, will be referred to SERS' Chief Investment Officer.

### 1. MERGERS AND ACQUISITIONS

As a general rule, SERS will vote **for** management when a corporation is merging with, or into, or being acquired by another firm on a friendly basis.

Any significant merger, acquisition or hostile bid, particularly a transaction where one party is headquartered in Pennsylvania, will be referred to SERS' Chief Investment Officer on a case-by-case basis. There are a number of factors to be considered when voting on any proposed merger or acquisition, including without limitation:

- Whether the proposed transaction would promote SERS' long-term financial interests;
- The existence of a fairness opinion in connection with the transaction;
- The existence of a majority of outside directors voting on the proposal, and the relative performance of their companies;
- Management's compensation in the transaction, and the treatment of shareholder rights in the resulting company;
- Whether various lock-up or lock-out provisions exist which prevent potential bidders from competing with management's offer; and
- In the case of a management buyout, whether other potential acquirers have the opportunity to make competitive bids.

### 2. PROPOSALS DESIGNED TO DISCOURAGE MERGERS AND ACQUISITIONS

These provisions direct board members to weigh socio-economic, legal, and financial factors when evaluating takeover bids. This allows the interest of customers, suppliers, managers, and other non-shareholders to be considered.

SERS will vote **against** these proposals.

### 3. CORPORATE TRANSACTIONS

SERS will generally vote **for** management proposals to make certain corporate transactions, such as spin-offs or asset sales. SERS prefers a fairness opinion, and a favorable stock market reaction, prior to casting its vote on such proposals.

### 4. LIQUIDATIONS

SERS will generally vote on a **case-by-case** basis on liquidation proposals after reviewing (i) management's efforts to pursue other alternatives, (ii) appraisal value of assets, and (iii) the compensation plan for executives managing the liquidation.

## 5. APPRAISAL RIGHTS

SERS will generally vote **for** proposals to restore, or provide shareholders with, rights of appraisal.

## 6. CHANGING CORPORATE NAME

SERS will vote **for** management proposals to change the name of the company.

## 7. MANDATORY TAKEOVER BID WAIVER

Many countries impose a bid threshold that forces any shareholder whose stake in a company exceeds the legal limit to tender a public bid to all the other shareholders to purchase the remaining shares. SERS votes **against** proposals to exempt a large shareholder from the obligation to bid. The requirement that a takeover bid should be launched when a substantial amount of shares have been acquired prevents the entrenchment of the controlling shareholder and protects minority owners.

**Note:** SERS does make an exception to the mandatory takeover bid rule when the event prompting the takeover bid is a repurchase by the company of its own shares. When a company repurchases its own shares, the relative stake of a large shareholder increases even though the number of shares held by the large shareholder has not changed. Under certain circumstances, SERS will support a waiver, namely, if the share repurchase would not push the large shareholder's stake in the company above 50%.

## 8. RELATED PARTY TRANSACTIONS

SERS will evaluate related-party transactions on a **case-by-case** basis, considering factors including, but not limited to, the following:

- The parties on either side of the transaction, including the identity and relationship;
- The nature of the asset to be transferred/service to be provided;
- The pricing of the transaction (and any associated professional valuation);
- The views of independent directors (where provided);
- The views of an independent financial adviser (where appointed);
- Whether any entities party to the transaction (including advisers) are conflicted; and/or
- The stated rationale for the transaction, including discussions of timing.

## **K. Mutual Fund and Exchange Traded Fund Proxies<sup>2</sup>**

### **1. ELECTION OF TRUSTEES**

SERS will vote on trustee nominees on a **case-by-case** basis, taking into account market best practices.

### **2. INVESTMENT ADVISORY AGREEMENTS**

SERS will vote on investment advisory agreements on a **case-by-case** basis, taking into account market best practices.

### **3. FUNDAMENTAL INVESTMENT RESTRICTIONS**

SERS will vote on amendments to a fund's fundamental investment restrictions on a **case-by-case** basis, taking into account market best practices.

### **4. DISTRIBUTION AGREEMENTS**

SERS will vote on distribution agreements on a **case-by-case** basis, taking into account market best practices.

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<sup>2</sup> Includes conversion of closed-end funds to open-end funds, as well as the approval of multi-manager structures.

## L. Social, Environmental and Political Issues

SERS will vote on social, environmental and political issues based on their effect on shareholder value and the financial impact on the company. Proposals will generally be voted with management, particularly where there are serious financial costs to the company. The following specific issues will be voted on as follows:

### 1. SUSTAINABILITY REPORTING

SERS generally votes **for** proposals requesting that a company report on its policies, initiatives, and oversight mechanisms related to social, economic, and environmental sustainability, unless:

- The company already discloses similar information through existing reports or policies such as an environment, health and safety (EHS) report, a comprehensive code of corporate conduct, and/or a diversity report; and/or
- The company has formally committed to the implementation of a reporting program based on Global Reporting Initiative (GRI) guidelines, or a similar standard within a specified time frame.

### 2. ESTABLISH OTHER BOARD COMMITTEE PROPOSALS

SERS generally votes **against** shareholder proposals to establish a new board committee, as such proposals seek a specific oversight mechanism/structure that potentially limits a company's flexibility to determine an appropriate oversight mechanism for itself. However, the following factors will be considered:

- Existing oversight mechanisms (including current committee structure) regarding the issue for which board oversight is sought;
- Level of disclosure regarding the issue for which board oversight is sought;
- Company performance related to the issue for which board oversight is sought;
- Board committee structure compared to that of other companies in its industry sector; and
- The scope and structure of the proposal.

### 3. LOBBYING

SERS will vote **for** proposals requesting information on a company's lobbying activities, policies, or procedures (including direct, indirect, and grassroots lobbying).

### 4. POLITICAL CONTRIBUTIONS

SERS will vote **for** proposals requesting greater disclosure of a company's political contributions, as well as its trade association spending policies and activities.

### 5. CHARITABLE CONTRIBUTIONS

SERS will vote **for** shareholder proposals requesting for disclosure or reporting of a company's charitable contributions.

## **M. Lack of Information**

It is impossible to determine the impact a proposal would have on shareholder value unless shareholders are furnished with detailed information. An uninformed voting decision can be harmful to shareholders.

Management proposals where little or no information is given to shareholders will be examined on a **case-by-case** basis.

SERS will **abstain** from proposals for lack of information where there is deemed to be poor disclosure laws in a given country (market specific).

SERS will vote **against** proposals if a company fails to provide shareholders with adequate information with which to base their voting decisions (company specific).