Section 2.0 ASSET CLASSES AND STRATEGIES

2.2 SPECIALIZED, NON-TRADITIONAL ALTERNATIVE INVESTMENT POLICY

Revised: July 14, 2009

TABLE OF CONTENTS

Section 2.0 ASSET CLASSES AND STRATEGIES

I. Introduction

This document sets forth the investment policy ("the Policy") for the Los Angeles City Employees' Retirement System's ("LACERS" or "the System") Specialized Alternative, Non-Traditional Investment Program, ("the Program"). This Policy is designed to ensure that managers, consultants, or other Program participants selected by LACERS are prudently selected and monitored to ensure the highest probability of the Program's success. This Policy provides assurance that there is sufficient flexibility in controlling the investment risks and returns associated with this segment of the portfolio.

The Program is designed to identify and to participate in alternative investment opportunities that are outside of its traditional private equity program.

II. Strategic Objective

The strategic objective of the Specialized Alternative Investment Program is to broaden the opportunity set of the System's investment portfolio to include opportunities not available in traditional private equity investments. Specialized alternative investments are expected to achieve attractive risk-adjusted returns that complement LACERS' traditional private equity program. Specialized alternatives may include, but are not limited to: emerging managers (i.e., smaller partnerships or experienced investment teams having worked together as a team i.e. lift out or a spin out of a larger investment firm raising their first institutional fund), funds focused on underserved markets (primarily defined by demographics: minority populations or lower income markets or geography: urban/inner city or rural), demographically targeted partnerships, geographically targeted investments, etc. These types of strategies are not represented in the traditional private equity portfolio. These types of opportunities may also exhibit a higher level of complexity or be a concept that is novel to the institutional marketplace.

Specialized alternative investments shall be considered solely in the interest of the System's participants and their beneficiaries in accordance with applicable law, and shall be selected to accomplish the following:

A. Enhance the System's long-term risk-adjusted return.
B. Hedge against long-term liabilities.
C. Provide added diversification to the System's overall investment program.

III. Investment Objectives

A. Return

The long-term (5-10 years) expected performance objective of the Program shall be 500 bps over the Russell 3000 Index net of fees, expenses, and carried interest. Use of the Russell 3000 Index reflects the opportunity cost of investing in alternative investments versus publicly traded common stocks. The Program is expected to outperform the traditional alternative investment portfolio by 100 bps over the long term (5-10 years).

B. Risks

Private equity investments, by definition, possess a higher degree of risk with a higher return potential than publicly traded investments. Accordingly, total rates of return from private equity investments are expected to be greater than those that might be obtained from conventional public equity or debt investments. The Board believes that there may be opportunities to achieve greater risk-adjusted returns through the investment in “specialized” alternative investment opportunities.

IV. Scope

Within the private equity asset classification the Specialized Alternative, Non-Traditional Investment (“carve-out”) Program, has targeted 10% of the overall private equity allocation.

Pension Consulting Alliance, Inc. (“PCA”) was engaged by LACERS in June 2005 as a non-discretionary advisor to source and review opportunities, perform due diligence and recommend new investments, to monitor existing investments, and to provide advice in accordance with the investment objectives for the carve-out portfolio. This policy establishes the framework for the continued development of the carve-out portfolio.

- PCA will be evaluated annually as a consultant and investment advisor for LACERS carve-out program based upon the following: portfolio performance; quality of analytical, technical work and recommendations, and expertise within their arena; responsiveness to requests from the Board and staff; availability to attend Board meetings and meetings with staff with reasonable advance notice; evaluating and making recommendations to LACERS including white papers on selected topics; identifying and mitigating risks, proactively informing staff of new ideas of risks in the marketplace.

V. Responsibilities and Delegations

A. The Board’s Investment Committee (“Committee”) shall recommend the approval and amendment of Investment Policy, Strategic Plan, Investment Plan, and investment opportunities to LACERS Board. In addition, the Board shall oversee program performance.

B. Staff shall manage day-to-day operations.

C. PCA is retained to assist in the development and implementation of the Program and acts as a fiduciary to the System.

Attachment 1 outlines specific responsibilities and tasks to be performed by the Board, Committee, Staff, and PCA.

VI. Investment Approaches and Parameters

A. General Approach

Under the Program, LACERS shall consider specialized, non-traditional investments utilizing a specialized management strategy that shall be disciplined and opportunistic. Opportunities shall be sought with specific criteria appropriate to partnership investments. Strategic assessments shall identify portfolio weightings and identify the most attractive segments of the market for opportunistic investing. Based on these assessments, LACERS and PCA shall proactively seek out attractive investment opportunities, while maintaining appropriate diversification.

Section 2.0 ASSET CLASSES AND STRATEGIES

B. Program Strategy

The Program Strategy shall be revised periodically as appropriate.

The Strategy shall contain the following elements:
1. Program goals and objectives;
2. Structure of the program;
3. Strategic approach to this asset class.

The Committee and Board shall review the program annually via the Investment Plan prepared by Staff and PCA. The Investment Plan shall be based upon broad economic structural analysis, market conditions, and a review of the existing portfolio. The Strategic Plan, which is a long-term view, shall detail tactical priorities, strategy enhancements, and other objectives.

Partnerships shall be continually reviewed in the following areas:
1. Fit with the Investment Plan;
2. Pace and timing of investment commitments, funding and return of capital;
3. Diversity of sectors (industry, geographical, investment style, and others as appropriate);
4. Targeted performance according to stated objectives specific to the investment;
5. Key personnel turnover.

C. Quality Control Processes

The Program shall employ a quality control process, which includes both the Staff and PCA to monitor Program activity, track investment performance, and control risk.
1. **Process Monitoring** - Staff and PCA shall monitor transaction processing to insure timely decision making and an effective process.
2. **Monitoring Portfolio Performance** - Actual returns will be compared to the benchmark(s) as appropriate, and to the expected return for the investment.
3. **Risk Control** - Documented due diligence activities.

D. Specific Risk Parameters

The Program will be exposed to specific risk parameters that are associated with investing in alternative investments, including, but not limited to:
1. **Financial Risk**: Alternative investments often employ a greater use of leverage (borrowing), which may lead to a greater volatility in returns.
2. **Operating and Business Risk**: Certain alternative investments entail above average operating and business risk.
3. **Liquidity Risk**: Alternative investments lack liquidity and typically have time horizons of 5-to-10 years. Secondary markets for such investments are very limited; and, often, there is no current income.
4. **Country Risk**: Political, economic, and currency risks associated with investing outside of the U.S.
5. **Structural Risk**: Specific fundamental rights and protections are negotiated, which include mechanisms for taking remedial action. These basic protections may include advisory committee participation and specific termination provisions in partnership transactions.

6. **Valuation Risk**: Partnerships shall be evaluated to determine if the general partner employs an appropriate valuation discipline.
7. **Strategy Risk**: Proposed investment strategies are expected to include newer, niche strategies that may be less proven than more traditional approaches.
8. **Organizational Risk**: Firms included in the portfolio may be representing newer firms with less history of working together, increasing risks of personnel turnover or other organizational instability.

E. Guidelines for Evaluating Proposals

Proposed partnership opportunities shall be evaluated relative to their fit with the Program's Investment Policy and Investment Plan. Guidelines for initial partnership evaluation are listed below:

1. **Organization**: Firms considered for this Program may include recently formed organizations that are raising their first institutional investment vehicle. Alignment of interests (including ownership, compensation, general partner commitment, etc.) will be important factors in the proposed investment opportunities. A preliminary review of these key factors should be considered in the initial evaluation.
2. **Investment Experience**: The general partners are expected to have significant investment experience and expertise relevant to their investment strategy. However, greater emphasis should be placed on the experience of the team rather than the firm as a whole as many opportunities may be teams splitting from more established firms ("emerging managers") raising their first institutional fund. This also pertains to analyzing track records. The track records of the team members may need to be examined on each members own merit rather than requiring a track record representative of the entire firm. The team should demonstrate that they are specifically qualified to pursue the proposed strategy in the market in which they propose to work.
3. **Staffing**: The organization must have sufficient investment professionals and support staff to implement the proposed strategy. The principals shall dedicate the majority of their time and effort to the proposed opportunity and make, within the context of the particular investment, a meaningful personal financial commitment. The amount of targeted capital commitments, average investment size and anticipated number of transactions should be reviewed to assess the appropriate staffing level.
4. **Investment Strategy**: The proposed strategy and business plan shall be set forth in sufficient detail to permit substantive and meaningful review of the opportunity, verification of the investment concept, and of the risk factors. The proposed strategy and business plan shall provide reasonable assurance that the investment opportunity can produce the required return. The investment strategy of potential investment opportunities are expected be differentiated primarily in two ways: i) a traditional investment strategy with a specialized focus or ii) a "cutting edge" investment strategy that is relatively new to the institutional marketplace; but the risk/reward trade-off in the particular investment strategy and/or market should be attractive and based on reasonable assumptions and not competitive with existing investments.
5. **Focus**: Potential investments may include a very specific investment focus that differentiates the opportunity from more traditional opportunities. These

opportunities may be focused on investing in “underserved markets”, emphasize investments that impact a particular demographic or possibly specify a designated geographic region for investment. These are only examples and the specific focus on any particular opportunity may be out of the above-mentioned areas of focus.

6. **Fund size**: The majority of potential opportunities are expected to be targeting commitments at the smaller end of the spectrum (i.e. less than $500 million). The target commitment for these funds can vary greatly, but given LACERS program size and the desire to minimize LACERS proportional ownership in a specific partnership, a potential candidate should raise at least $100 million, excluding LACERS commitment. LACERS commitment shall not represent more than 10% of the overall fund size.
7. **Type of Investments**: Opportunities to be reviewed for the Program are expected to span private equity segments, including: buyout/corporate restructuring, expansion capital, venture capital, energy/natural resources, distressed securities, international, and special situations.
8. **Terms**: At a minimum, partnership terms are expected to be “in-line” with industry norms. However, it is anticipated that LACERS (through PCA) should be able to negotiate various terms, particularly governance terms, to be “limited partner friendly” in order to compensate LACERS for the unique risks associated with investing in these types of opportunities.
9. Additional factors may include, as appropriate:
   a. Fit with the Program Strategy, Investment Policy and Investment Plan, and within the overall Program;
   b. A unique strategy that is not competitive with existing investments;
   c. Integrity of the general partner, its employees, and other investors;
   d. Quality of overall partnership governance, management of the partnership, including controls and reporting systems;
   e. Specific objectives;
   f. Relationship with the relevant parts of the investment community;
   g. Relationship with limited partners;
   h. Nature of value added involvement;
   i. Past financial performance of the individual investment professionals;
   j. Reasonable ratio of portfolio companies per partner;
   k. Reasonable ratio of committed capital per partner;
   l. Appropriateness of terms and conditions and alignment of interests with limited partners;
   m. Capital at risk;
   n. Fund size sufficient to cover management expenses;
   o. Principals dedicate the majority of their time to the partnership.
10. Extensive due diligence will be completed by Staff and PCA and shall include but not limited to the following:
   a. Discussions with principals of the proposed investment;
   b. Review and analysis of all pertinent offering documents including: offering memorandums, subscription agreements, and private placement memorandums;
   c. Consideration of potential conflicts of interest, if any, posed by the proposed investment and prior investments and activities of the principals;

d. Review and analysis of the investment concept, including entry and exit strategies and terms including fees, principal participation, and structure;
e. Review and analysis of the fit within the Program, including fit with the Investment Plan, other constraints and guidelines, and compliance with applicable investment policies;
f. Review of news articles, principals, prior investments, and concepts;
g. Reference checks of principals;
h. Review and analysis of track record including performance of prior and current investments;
i. Consideration of relative size of the proposed investment;
j. Investigation of special terms and side letter agreements with past or present investors;
k. Review of any lawsuits, litigation involving the general partner, its principals, employees and prior funds;
l. Due diligence visit to the Partner's offices;
m. Adherence to LACERS Marketing Cessation Policy (see Attachment 2) and LACERS Disclosure Policy (see Attachment 3);
n. Direct general partners to address workforce composition either through completion of the Workforce Composition form or through a letter addressing their internal policy.

11. Legal Constraints

Legal provisions to be considered include, but are not limited to:

a. Unrelated Business Taxable Income (UBTI): Partnerships are structured to minimize UBTI;
b. Registered Investment Advisor (RIA): Investment advisors retained by the Board are so registered or comparable procedure is established;
c. Regulatory (i.e. FCC, SEC, FTC);
d. Bankruptcy or other material litigation;
e. Appropriate alignment of interests.

F. Types of Investments

Partnerships with expected risk/return superior to traditional private equity investment opportunities or that enhance portfolio diversification, and are not otherwise prohibited by the System will be considered for the Program. Partnerships shall generally fall within the categories defined below but will have specialized features that differentiate the opportunity. Such specialized features may include being an "emerging manager" or targeting "underserved markets" (specific demographics, or geographic region), for example. When all else is considered equal regarding performance, strategy, personnel, philosophy and other critical criteria, between top tier investment managers, preference may be given to Los Angeles based managers.

1. **Buyout and Corporate Restructuring Capital**: Investments in leveraged buyouts, management buyouts, equity buyouts, employee buyouts, buy-and-build, other acquisition strategies and restructurings, and related uses of capital.
2. **Expansion Capital**: Investments in established companies for the purpose of growing their businesses.
3. **Venture Capital**: Investments in relatively small, rapidly growing, private companies in various stages of development.

4. **Energy and Natural Resources**: Investments in the exploration, extraction, accumulation, generation, movement or sale of energy (e.g., oil, gas, coal, electricity), and other natural resources and related service companies.
5. **Distressed Securities**: Debt or equity securities investments in troubled companies, under the assumption that the securities will appreciate in value following a restructuring of the company's obligations. This includes, but is not limited to, investments in companies that are insolvent or unable to pay their debts as they come due. This may include companies subject to the Bankruptcy Reform Act, specifically Chapter 7 (Liquidation) and Chapter 11 (Reorganization), and companies under-going restructurings outside of Bankruptcy Court.
6. **Turnarounds**: Investments in companies experiencing financial or operating difficulties. These companies may or may not be insolvent.
7. **International**: Investments that are located in foreign countries or have significant portions of their operations outside of the United States. International investments shall also be considered with respect to their specific type (e.g., corporate restructuring, venture capital, and so forth).
8. **Special Situations**: This includes all other types of investments, e.g., mezzanine strategies, active minority positions, hedge funds, secondary investments, governance strategies, industry specific strategies, and unconventional investments.

G. Reporting and Monitoring

Reporting

1. Reports received from investment managers.
   - Staff shall require periodic reports (i.e. quarterly) from investment partners to facilitate monitoring.

2. Monitoring Investments.
   - Staff and PCA shall monitor individual partnerships and the portfolio as a whole. Monitoring includes diversification across alternative investment types to assure an appropriate mix reducing risk in the Program's investments. Given the focused nature of the Program, specific areas may be emphasized over the short-term with the long-term goal of developing a diversified program.

   The following types of diversification should be monitored, including, but not limited to:

   a. Economic Sector Diversification- Alternative investments should be diversified among sector groups;
   b. Form of Investment - Alternative investments should be diversified throughout various forms and categories of investment (e.g., LBO's, venture capital, distressed, mezzanine etc.);
   c. Payback Diversification - Alternative investments can take significant time to pay back capital. LACERS should attempt to invest in partnerships across a spectrum of payback scenarios;
   d. Geographic Diversification- LACERS should consider geographical diversification in investment selection; and

Section 2.0 ASSET CLASSES AND STRATEGIES

e. Time Diversification - LACERS should endeavor to invest in a consistent manner when appropriate risk adjusted return opportunities are available.

3. Performance
The System shall assess the performance of partnerships relative to the following areas:
a. Objectives established by the partnership;
b. Risk undertaken;
c. The long-term performance objective, with appropriate interpretation if applied to the short-term;
d. Vintage year peer comparisons.

4. Board Reports
Quarterly and annual reports shall be provided to the Committee and/or Board. These reports include, but shall not be limited to, reviews of investments and their performance, and a semi-annual partnership commentary.

Attachment 1

DESIGNATED RESPONSIBILITIES AND TASKS

RESPONSIBILITIES OF LACERS' BOARD

Selection of a Consultant

- Monitor the performance of the consultant

Policy and Strategy Development

- Approve:
  Investment Policy
  Strategic Plan

Due Diligence

- Review due diligence report prepared by Consultant, reviewed by staff, and Investment Committee recommendation
- Approve or reject proposed investment opportunity

Performance Monitoring

- Receive and review performance reports from Consultant

RESPONSIBILITIES OF LACERS' INVESTMENT COMMITTEE

Policy and Strategy Development

- Review/recommend approval and amendment of:
  Investment Policy
  Strategic Plan

Due Diligence

- Review due diligence report prepared by Consultant with staff concurrence or if non-concurrence, noted
- Interview management teams of proposed investments
- Recommend to Board the individual investments

Performance Monitoring

- Receive and review performance reports from Consultant

Investment Referrals

- Identify and refer partnerships to staff and/or Consultant for review.

RESPONSIBILITIES OF LACERS' STAFF

Recommendations to the Committee

- Develop recommendations regarding Investment Policies, Strategies, Guidelines

Investment Opportunity Sourcing

- Receipt of partnership referrals from Board members, Consultant, for further review
- Perform initial gatekeeper functions by meeting with groups, reviewing the investment documentation including the Private Placement Memorandums and Offerings documents
- Conduct joint due diligence meetings with consultant on prospective partnerships
- May perform preliminary due diligence prior to referring to consultant for further review, detailed analysis, and due diligence

Due Diligence

- Forward contact information and materials to Consultant for opportunities meeting the initial evaluation criteria
- Initiates Desk Review to be performed by Consultant/Staff
  - o Review consultant Desk Review
    - Determine if continued due diligence is warranted

- Full Due Diligence Review conducted by Consultant and staff
  - Initiates outside legal review
  - Communicate status of legal review to Consultant
  - Legal counsel completes legal review and opines as to its acceptability; include recommendation to LACERS
- Review consultant due diligence reviews, analysis, and recommendations for qualitative and quantitative reasonableness;
  - Recommend to the Committee if appropriate;

Investment Administration

- Board-approved partnerships are executed by staff
  - Reviews and approves contracts, modifications, and other documentation;
  - Manages day to day LACERS operations, including setting up communications, setting up the appropriate custodial accounts, data requirements, and standard wire instructions
  - Makes capital calls
  - Receives and processes distributions
  - Reviews and processes a variety of reports from managers

Performance Monitoring

- From Partnerships
  - Receives and reviews quarterly reports
- From Consultant
  - Receives and review reports
    - Quarterly: one-page status report per manager
    - Semi-Annual: full performance report
    - Annual: market overview, Investment Policy, and Investment Plan
    - Ad hoc review of consultant database as needed

RESPONSIBILITIES OF THE CONSULTANT

Deal Flow Management

- Sourcing
  - Receive and review opportunities forwarded from LACERS
  - Document referral of investment opportunities
  - Meet and interview potential investment management teams
  - Evaluate opportunities presented outside of the LACERS relationship for appropriateness of the Program
  - Maintain a database of opportunities considered for the Program Investment Due Diligence to include the source of the recommendation
- Desk Review, initiated by LACERS:
  - Provide Marketing Cessation Policy
  - Review due diligence questionnaire, offering memorandum, limited partnership agreement, marketing materials, etc.
  - Analyze:
    - Market opportunity
    - Investment strategy
    - General Partner background and experience
    - Track record
    - Terms
    - Alignment of interest
  - Upon completion, review findings with LACERS and recommend review or rejection

Section 2.0 ASSET CLASSES AND STRATEGIES

- Full Diligence Review
  - Conduct reference checks
  - Conduct online visit as appropriate
  - Extensively review economic and business terms of legal documents
  - Disclosure of involvement of any placement agent compensation/or other consideration
  - Communicate status of Full Diligence Review to LACERS
  - Upon completion, prepare and issue report to LACERS with recommendation for investment or rejection; include appropriate supporting documents with the report
  - Arrange meeting to review materials and recommendation
- Terms Negotiation:
  - Negotiate specific partnerships terms, if appropriate

Performance Monitoring

- Consultant
  - Receives copies of all notices of capital calls and cash distributions
  - Receives copies of all financial reports and other communications
  - Calculates performance and reconciles same with the manager and master custodian, as needed
  - Prepares periodic reports
    - Quarterly: one-page status report listing:
      - Partnership
      - Commitment
      - Contributions
      - Distributions
      - Fair Market Value
      - IRR
    - Semi-Annual: full performance report
      - Containing brief market overview
      - Performance by manager, vintage year and segment
      - Review portfolio exposures/diversification
      - Provide manager specific data/updates
    - Annual: market overview, Investment Policy, and Investment Plan review
  - Interface quarterly with Traditional Alternative Investment Consultant to integrate status of the Program into the traditional portfolio

Attachment 2
Page 1

MARKETING CESSATION POLICY

Adopted: April 24, 2007; Revised June 10, 2014

Purpose
The purpose of this policy is to ensure a transparent and fair contracting process which provides equal information and opportunity to all parties interested in contracting with LACERS. The policy helps prevent, and avoid the appearance of, undue influence on the Board or any of its Members in the award of investment related and other service contracts by placing restrictions on communications between parties seeking contracts and those involved in contract award and the contract process.

Parties Affected
Any firm or representative seeking a contract or contract extension/renewal with LACERS is a "Restricted Source" as defined by the City's Governmental Ethics Ordinance, and is subject to this policy.

Any Board Member, Staff member, City Attorney, LACERS consultant, or anyone working on LACERS' behalf which has any privileged information about the potential contract is subject to this policy.

Notification
All firms responding to a Request for Proposal are notified of the Department's Marketing Cessation Policy through the Request for Proposal solicitation. All firms whose contracts are approaching expiration are additionally notified of the Marketing Cessation Policy through their contract provisions.

Restricted Period
Restrictions apply from the time the Request for Proposal is released until a contract is executed.

Restrictions:

Communication Restrictions
All firms that are potential candidates for the award of a contract, or extension of an existing contract, are prohibited from engaging in any direct or indirect marketing of their services except through the process set forth in the Request for Proposal. This includes a prohibition on conversations about the contract or the process to award it, but does not exclude conversations with restricted sources about generic topics at group social events, educational seminars, conferences, or charitable events.

Communications with firms who currently have contracts with LACERS are acceptable when they are related to the performance of the existing contract.

Gift Restrictions
In addition to all other applicable gift restrictions, Board Members and Staff will accept no entertainment or gifts of any kind from any Restricted Source, or intermediary, during the restricted period. An incumbent firm is also restricted from providing any type of gift or entertainment to Board Members or Staff during the three months prior to renewal of the existing contract or during the restricted period, whichever is longer.

Attachment 2
Page 2

Proposer Disclosure

All Proposers shall provide the following disclosures with their RFP response. All recommendations to the Board to award a contract shall include a copy of such disclosures:

9. All respondents are required to submit a statement listing all contacts with Board Members, Staff, and Consultants during the restricted period.
10. All respondents shall provide information regarding any personal or business relationship between their personnel and any Member of the Board, Staff of LACERS, or Consultants who are designated as Form 700 filers in the Department's Conflict of Interest Code.
11. All respondents shall disclose any payments for marketing or placement services to any person, firm, or entity to assist in seeking the LACERS contracting opportunity.

Penalties

Any failures to disclose, or false disclosures, are a violation of this policy shall result in automatic disqualification of the firm involved.

This policy shall be reviewed by the Board every three years or earlier if necessitated by a change in local, State, or Federal statutes.

Attachment 3

THIRD PARTY MARKETING AND REFERRALS DISCLOSURE POLICY

Firms submitting investment proposals for consideration by LACERS are hereby required to disclose the identity of all third-party marketers and/or individuals by whom the Firm has been referred to LACERS, and further indicate those so identified that stand to receive fees or other considerations in the event that a contract between the Firm and LACERS is secured.