



**Alameda County Employees' Retirement Association
BOARD OF RETIREMENT**

INVESTMENT COMMITTEE/BOARD MEETING

THIS MEETING WILL BE CONDUCTED VIA TELECONFERENCE [SEE SECTION 42 OF EXECUTIVE ORDER N-08-21 ATTACHED AT THE END OF THIS AGENDA.]

ACERA MISSION:

To provide ACERA members and employers with flexible, cost-effective, participant-oriented benefits through prudent investment management and superior member services.

**Wednesday, July 14, 2021
9:30 a.m.**

ZOOM INSTRUCTIONS	COMMITTEE MEMBERS	
The public can view the Teleconference and comment via audio during the meeting. To join this Teleconference, please click on the link below. https://zoom.us/join Webinar ID: 834 0709 2182 Passcode: 471114 For help joining a Zoom meeting, see: https://support.zoom.us/hc/en-us/articles/201362193	GEORGE WOOD, CHAIR	ELECTED GENERAL
	JAIME GODFREY, VICE-CHAIR	APPOINTED
	DALE AMARAL	ELECTED SAFETY
	OPHELIA BASGAL	APPOINTED
	KEITH CARSON	APPOINTED
	TARRELL GAMBLE	APPOINTED
	LIZ KOPPENHAVER	ELECTED RETIRED
	HENRY LEVY	TREASURER
	DARRYL L. WALKER	ELECTED GENERAL¹
	NANCY REILLY	ALTERNATE RETIRED²
	VACANT	ALTERNATE SAFETY

¹Trustee Walker is filling the vacancy created by Trustee Rogers' retirement. See Gov't Code §§ 31524, 31520.1(b)

² Alternate Retired Member (Votes in the absence of the Elected Retired Member, or, if the Elected Retired Member is present, then votes if both Elected General members, or the Elected Safety Member and an Elected General member, are absent).

Note regarding accommodations: The Board of Retirement will provide reasonable accommodations for persons with special needs of accessibility who plan to attend Board meetings. Please contact ACERA at (510) 628-3000 to arrange for accommodation.

Note regarding public comments: Public comments are limited to four (4) minutes per person in total.

The order of agenda items is subject to change without notice. Board and Committee agendas and minutes, and all documents distributed to the Board or a Committee in connection with a public meeting (unless exempt from disclosure), are available online at www.acera.org.

INVESTMENT COMMITTEE/BOARD MEETING

NOTICE and AGENDA, Page 2 of 2 – July 14, 2021

Call to Order: 9:30 a.m.

Roll Call:

Public Input (The Chair allows public input on each agenda item at the time the item is discussed)

Action Items: Matters for discussion and possible motion by the Committee

1. Discussion and Possible Motion to recommend that the Board approve an Updated Absolute Return Policy

9:30 – 10:15 Margaret Jadallah, Verus Advisory Inc.
Clint Kuboyama, ACERA
Betty Tse, ACERA

Information Items: These items are not presented for Committee action but consist of status updates and cyclical reports

1. Report on the Proposed Timeline, Search Criteria, and Evaluation Matrix for ACERA's Absolute Return (Custom Fund of Hedge Funds) Manager Search

Margaret Jadallah, Verus Advisory Inc.
Clint Kuboyama, ACERA
Betty Tse, ACERA

2. Oral Status Update on Implementing the Following:

- a. The newly approved Asset Allocation
- b. The pre-fundings from Alameda County and LARPD

Margaret Jadallah, Verus Advisory Inc.
Thomas Taylor, ACERA
Betty Tse, ACERA

Trustee Remarks

Future Discussion Items

Establishment of Next Meeting Date

August 11, 2021 at 9:30 a.m.

42) Executive Order N-29-20, Paragraph 3, is withdrawn and replaced by the following text:

Notwithstanding any other provision of state or local law (including, but not limited to, the Bagley-Keene Act or the Brown Act), and subject to the notice and accessibility requirements set forth below, a local legislative body or state body is authorized to hold public meetings via teleconferencing and to make public meetings accessible telephonically or otherwise electronically to all members of the public seeking to observe and to address the local legislative body or state body. All requirements in both the Bagley-Keene Act and the Brown Act expressly or impliedly requiring the physical presence of members, the clerk or other personnel of the body, or of the public as a condition of participation in or quorum for a public meeting are hereby waived.

In particular, any otherwise-applicable requirements that

- (i) state and local bodies notice each teleconference location from which a member will be participating in a public meeting;
- (ii) each teleconference location be accessible to the public;
- (iii) members of the public may address the body at each teleconference conference location;
- (iv) state and local bodies post agendas at all teleconference locations;
- (v) at least one member of the state body be physically present at the location specified in the notice of the meeting; and
- (vi) during teleconference meetings, a least a quorum of the members of the local body participate from locations within the boundaries of the territory over which the local body exercises jurisdiction

are hereby suspended.

A local legislative body or state body that holds a meeting via teleconferencing and allows members of the public to observe and address the meeting telephonically or otherwise electronically, consistent with the notice and accessibility requirements set forth below, shall have satisfied any requirement that the body allow members of the public to attend the meeting and offer public comment. Such a body need not make available any physical location from which members of the public may observe the meeting and offer public comment.

Accessibility Requirements: If a local legislative body or state body holds a meeting via teleconferencing and allows members of the public to observe and address the meeting telephonically or otherwise electronically, the body shall also:

- (i) Implement a procedure for receiving and swiftly resolving requests for reasonable modification or accommodation from individuals with disabilities, consistent with the Americans with Disabilities Act and resolving any doubt whatsoever in favor of accessibility; and
- (ii) Advertise that procedure each time notice is given of the means by which members of the public may observe the meeting and offer public comment, pursuant to subparagraph (ii) of the Notice Requirements below.

Notice Requirements: Except to the extent this Order expressly provides otherwise, each local legislative body and state body shall:

- (i) Give advance notice of the time of, and post the agenda for, each public meeting according to the timeframes otherwise prescribed by the Bagley-Keene Act or the Brown Act, and using the means otherwise prescribed by the Bagley-Keene Act or the Brown Act, as applicable; and
- (ii) In each instance in which notice of the time of the meeting is otherwise given or the agenda for the meeting is otherwise posted, also give notice of the means by which members of the public may observe the meeting and offer public comment. As to any instance in which there is a change in such means of public observation and comment, or any instance prior to the issuance of this Order in which the time of the meeting has been noticed or the agenda for the meeting has been posted without also including notice of such means, a body may satisfy this requirement by advertising such means using "the most rapid means of communication available at the time" within the meaning of Government Code, section 54954, subdivision (e); this shall include, but need not be limited to, posting such means on the body's Internet website.

All of the foregoing provisions concerning the conduct of public meetings shall apply through September 30, 2021.



TO: Members of the Investment Committee
 FROM: Clint Kuboyama, Investment Officer *Clint Kuboyama*
 DATE: July 14, 2021
 SUBJECT: Discussion and Possible Motion to recommend that the Board approve an Updated Absolute Return Policy

Recommendation:

Approve the recommended updates to the Absolute Return Policy.

Summary:

Following the Board-approved changes to the Absolute Return (AR) Asset Class structure (April 15, 2021) and the AR Asset Class' target weighting in the Total Fund (June 17, 2021), Staff and Verus recommend updating the AR Policy to reflect these actions. Staff and Verus also recommend approval for two additional updates to the AR Policy that implement: 1) consistent nomenclature for fund-of-hedge-fund investments; and 2) language that reflects ACERA's preference¹ for custom fund of hedge funds versus off-the-shelf, commingled fund of hedge funds. Collectively, these proposed changes comprise the AR Policy updates Staff and Verus recommend and are exhibited in Attachment #1 – the Current ACERA Absolute Return Policy Redlined for Recommended Updates.

Background:

On April 15, 2021, the ACERA Board approved a structural change in the AR Asset Class shown in Table 1 below.

Table 1: ACERA Board Approved Absolute Return Asset Class Structural Change			
<u>Investment Sub-Class</u>	<u>Approved Targets</u>	<u>Previous Targets</u>	<u>Difference</u>
Alternative Premia Strategies	0%	50%	-50%
Fund of Hedge Funds	80%	40%	40%
Other Alternatives/Oppportunistic	20%	10%	10%

On June 17, 2021, the ACERA Board approved a new Total Fund Asset Allocation, which lowered the target weighting of the AR Asset Class from 9% to 8%.

As the AR structure and the AR Asset Class' target weighting in the Total Fund are defined within the AR Policy, Staff and Verus are now recommending that the Board-approved structural change and the change in the asset class' target weighting are reflected across the AR Policy. The related redlined changes to the AR Policy are found in Attachment #1 on: 1) Page 3, Section IV TYPES OF ABSOLUTE RETURN INVESTMENTS; 2) Pages 4-5, Section VI STRATEGIC ALLOCATION TO ABSOLUTE RETURN PORTFOLIO; 3) Pages 5-6, Section VII SPECIFIC GUIDELINES FOR ABSOLUTE RETURN PORTFOLIO; and 4) Pages 14-16, Appendix III Compliance Checklist Template for Absolute Return Investment Selection.

¹ The Board-approved AR Asset Class structure is 80% Fund of Hedge Funds and 20% Other Alternatives/Oppportunistic. The 80% Fund of Hedge Funds allocation is being implemented with two custom fund of hedge funds. ACERA currently has one custom fund of hedge funds (Lighthouse) and Staff and Verus are proposing to hire a second custom fund-of-hedge-funds manager through a focused-list search.

To create nomenclature consistency across the AR Policy in reference to fund-of-hedge-funds investments, Staff and Verus also recommend updating the AR Policy such that the term “fund of hedge funds” and the acronym “FOHF” are used across the AR Policy, replacing other terms and acronyms used to describe this investment type. These related changes are found in Attachment #1 on: 1) Page 3, Footnote 3; 2) Page 4, Section IV TYPES OF ABSOLUTE RETURN INVESTMENTS, Section VI STRATEGIC ALLOCATION TO ABSOLUTE RETURN PORTFOLIO, and Footnote 3; 3) Pages 5-6, Section VII SPECIFIC GUIDELINES FOR ABSOLUTE RETURN PORTFOLIO; and 4) Pages 14 and 16, Appendix III Compliance Checklist Template for Absolute Return Investment Selection.

Finally, to include language in the AR Policy that summarizes ACERA’s preference for custom fund of hedge funds versus off-the-shelf, commingled fund of hedge funds, Staff and Verus recommend updating the AR Policy to include footnote 5 on Page 4.

Attachments:

#1 Current ACERA Absolute Return Policy Redlined for Recommended Updates, prepared by Staff

**Alameda County Employees'
Retirement Association**

ACERA

ABSOLUTE RETURN POLICY

Amended July 15, 2021 ~~September 21, 2017~~

ACERA ABSOLUTE RETURN POLICY

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I. SCOPE

This Absolute Return Policy (“AR Policy”) governs all investments in the Absolute Return asset class made by Alameda County Employees’ Retirement Association (“ACERA”).¹ The investments governed under this AR Policy were previously governed by the PEARLS Policy which was established on September 18, 2008, and are subject to all provisions of applicable law and the applicable limitations and requirements of ACERA’s General Investment Guidelines, Policies and Procedures. If there is any conflict between this AR Policy and ACERA’s General Investment Guidelines, Policies and Procedures pertaining to investments in the Absolute Return Asset Class, the AR Policy prevails. The ACERA Board (“Board”) reserves the right to amend, supplement, or rescind this AR Policy at any time.

II. PURPOSE

The purpose of this AR Policy is to 1) set forth the Absolute Return policies and guidelines which are deemed to be appropriate and prudent; 2) establish criteria against which Absolute Return investment opportunities are to be measured; and 3) serve as a review document to guide the ongoing oversight of ACERA’s Absolute Return Portfolio (“AR Portfolio”) on a consistent basis. The AR Policy also defines roles and responsibilities of the Board, the ACERA Investment Committee (“Investment Committee”), the ACERA Staff (“Staff”), the ACERA Absolute Return Consultant (“Consultant”), and the Absolute Return Investment Managers hired by ACERA to manage its assets (“Investment Managers”).

It is expected that this AR Policy will be a living document and that changes will be made from time-to-time to reflect experience, evolving investment products, and opportunities and changes in the economic and capital market environment.

III. LEGAL AUTHORITY

This AR Policy is established in accordance with Article XVI, Section 17 of the California Constitution and California Government Code sections 31594 and 31595, which establish the exclusive authority and fiduciary responsibility of the Board for the investment and administration of the ACERA Trust Fund (“Fund”).

IV. TYPES OF ABSOLUTE RETURN INVESTMENTS

For purpose of this AR Policy, Absolute Return strategies are defined as non-traditional investments which are intended to generate a return stream that has a low correlation to equity markets. These investments are generally expected to have a correlation to the equity markets at a level of 0.5 or less, and are expected to provide downside protection in falling equity markets. Further, these investments in aggregate should not have a correlation to the equity markets that exceeds the HFRI² Fund of Funds Composite Index.³ Eligible Absolute Return investments include ~~alternative premia~~⁴

¹ See ACERA’s Private Equity Investment Policy, Real Estate Policy, and Real Assets Policy for investments in other asset classes.

² HFRI stands for Hedge Fund Research, Inc.

³ Fund of (Hedge) Funds invest with multiple managers through funds or managed accounts. The strategy designs a diversified portfolio of managers with the objective of significantly lowering the risk (volatility) of investing with an individual manager. The

strategies, fund of hedge funds⁵ hedge fund of funds, and other alternatives/opportunistic strategies. These investments are privately placed investments.

ACERA may consider investing in these assets if, and only if, the vehicles meet all standards pursuant to the AR Policy. Absolute Return investments may be denominated in U.S. dollars or other currencies.

V. STRATEGIC OBJECTIVE OF ABSOLUTE RETURN STRATEGIES

-The Board believes the Fund's overall returns can be enhanced, on a risk-adjusted basis, by investing a portion of its assets in Absolute Return strategies. The strategic objective of such investments is to: 1) generate superior returns commensurate with risk taken using strategies that have a low correlation to the equity markets; 2) enhance ACERA's long-term, risk-adjusted return and provide additional diversification to ACERA's overall investment Fund; -and, 3) generate total AR Portfolio returns at or above the HFRI Fund of Funds Composite Index (net of all fees and expenses).

VI. STRATEGIC ALLOCATION TO ABSOLUTE RETURN PORTFOLIO

The long-term target allocation to the AR Portfolio, as measured by the Net Asset Value of the portfolio and not by dollars committed to the underlying Investment managers or funds, is 89% of the Total Fund. The allocation to the AR portfolio can range from 4.0% to 10.0-5% with exposure to the sub-asset classes as follows:

Portfolio	Long-Term Target Allocations	Min./Max. Ranges
Absolute Return Portfolio	89.0%	4.0% to 10.0-5%
- <i>Alternative Premia Strategies</i>	<i>50%</i>	<i>20% to 70%</i>
- <i>Funds of Hedge Funds</i>	<i>48.0%</i>	<i>20.50% to 70.100%</i>
- <i>Other Alternatives/ Opportunistic</i>	<i>12.0%</i>	<i>0% to 50%</i>

Fund of (Hedge) Funds manager has discretion in choosing in which strategies to invest for the portfolio. A manager may allocate funds to numerous managers within a single strategy, or with numerous managers in multiple strategies. The minimum investment in a Fund of (Hedge) Funds may be lower than an investment in an individual hedge fund or managed account. The investor has the advantage of diversification among managers and styles with significantly less capital than investing with separate managers. Source is: www.hedgefundresearch.com/hfri-indices-index-descriptions

⁴ Alternative premia... are well known, empirically tested, sources of return that can be systematically harvested through dynamic strategies. They can be thought of as returns that underlie "classic" hedge fund strategies (hedge fund risk premia) or the returns from "classic" styles (style premia), such as value, momentum, and carry. From: AQR.

⁵ Structures customized to ACERA's objectives, such as custom fund of hedge funds (aka hedge fund of ones), are preferred all else being equal.

Total	89.0%	4.0% to 10.05%
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Portfolio construction will be designed to produce a diversified mix of total returns, subject to the guidelines and constraints outlined under each sub-category below. As with any investment, invested capital may incur losses of all or part of the capital invested, it is expected that a diversified AR Portfolio will produce a positive return commensurate with risk taken through the harnessing of return sources that are generally uncorrelated to the equity markets over the long term (typically full market cycle). Risks associated with this Portfolio include, but are not limited to, leverage, shorting, frequent trading, lack of transparency, and lower liquidity compared to long-only investments in public markets. The risks associated with the AR Portfolio will be viewed within the context of the entire Fund. ACERA may take on over- and under-weights to sub-asset classes within the AR Portfolio to improve its risk/return posture based upon an assessment of the relative attractiveness of all available opportunities.

VII. SPECIFIC GUIDELINES FOR ABSOLUTE RETURN PORTFOLIO

ACERA will gain exposure to Absolute Return investments by hiring external investment managers either directly or through a fund-of-hedge-funds vehicle. Overall it is expected that the AR Portfolio will produce returns approximately equal to or greater than the HFRI Fund of Funds Composite Index over a market cycle, net of all fees and expenses. It is furthermore expected that the pattern of the returns generated across the AR Portfolio will provide additional diversification, i.e., exhibit a low correlation to the equity markets, the Private Equity Portfolio and the rest of the ACERA investment portfolio.

At the AR Portfolio level, the maximum that can be invested in an individual strategy (fund) is ~~30~~25% of the target allocation to the AR Portfolio, and the maximum that can be invested with a given manager is ~~45~~50% of the target allocation to the AR portfolio. Descriptions of subcategories of the AR Portfolio and their guideline constraints are listed below:

~~1. Alternative Premia (AP) Strategies~~

~~Description: For purposes of this AR Policy, Alternative Premia (AP) strategies are those which seek to replicate or harness the return sources and risk exposures typical of hedge fund (and hedge funds of funds) strategies at a lower cost than investing directly in hedge funds and in a more liquid, transparent fashion. These may include, but are not limited to: long/short equity, event driven, convertible arbitrage, equity market neutral, fixed income arbitrage, macro, value, momentum, and quality.~~

~~Investment Constraints: Individual AP investments have a target allocation of 25% of the target value of the AR Portfolio but can range in size between 10% and 30%.~~

~~2.1 Funds-of-Hedge Funds (FOHF) Strategies~~

~~Description: Investment in a diversified portfolio of hedge funds, with oversight and asset allocation determined by a ~~fund-of-hedge-funds~~hedge fund-of-funds manager. The focus of this AR Policy's FOHF strategies is on maximizing alpha across different asset~~

classes and investment strategies. These portfolios are not typically constrained to an individual asset class, but are intended to augment total return to the plan by utilizing proprietary strategies. These may include, but are not limited to: long/short equity, event driven, convertible arbitrage, equity market neutral, fixed income arbitrage, macro, and other hedge fund strategies. ACERA's AR Portfolio will utilize fund of hedge funds~~hedge fund-of-funds~~ whose fees are better aligned with investor interests (lower fee options).

Investment Constraints: Individual FOHF investments have a target allocation of ~~24~~0% of the target value of the AR Portfolio but can range in size between 10% and ~~45~~0%.

3-2 Other Alternative Investments/Oppportunistic

Description: Other Alternative Investments/Oppportunistic include a wide range of innovative, uncorrelated, and/or non-traditional investments that fall outside of ACERA's previously identified asset classes (i.e. domestic equities, international equities, fixed income, real estate, real assets, and cash). The unique attributes of these investments should contribute to the achievement of the overall return and diversification objectives of the AR Portfolio. Because the AR Portfolio is intended to respond opportunistically to attractive prospects as they arise, not all potential investments can be identified at present. The investment categories of Other Alternative Investments/Oppportunistic include, but are not limited to, currency, interests in equity or revenues of investment managers, and other "best ideas" uncorrelated approaches, etc.

Investment Constraints: Investment constraints are subject to the specific investment selected. Maximum strategy/manager positions are targeted to be smaller than for fund-of-hedge-funds strategies ~~the other two sub-asset classes~~ within the AR Portfolio, but can individually range up to 25% of the target value of the AR Portfolio.

VIII. ROLES AND RESPONSIBILITIES

The delineation of roles and responsibilities is important for effective administration of ACERA's AR Portfolio. The duties and responsibilities of the Board, Investment Committee, Staff, Consultant, and Investment Managers are stated below:

A. Board

The Board shall be responsible for approving the AR Policy that governs the AR Portfolio and approving the investment plans of ACERA's AR Portfolio. The Board, with input from the Investment Committee, shall review this AR Policy to determine whether amendments are necessary. The Board shall also be responsible for reviewing and approving all AR investments with individual commitments exceeding Staff's delegated authority as described in subparagraph C below.

B. Investment Committee

The Investment Committee shall be responsible for the following:

1. Establishing the AR Policy to govern all investments in the Absolute Return asset class;
2. Reviewing the AR Policy, evaluating proposals for the AR Policy amendments, if any, and making recommendations for approval by the Board;
3. Reviewing and approving the investment plan of ACERA's AR Portfolio every 1 to 3 years;
4. Reviewing Absolute Return investments recommended by Staff and/or Consultant and making recommendations to the Board for adoption; and
5. Delegation⁶:
 - a. Delegating to Staff the authority to make final decisions on new proposed Absolute Return investments with an individual commitment up to 5% of the target allocation to the total AR Portfolio or \$25 million (whichever is lesser).
 - b. Delegating to Staff the authority to make final decisions on proposed "re-up" Absolute Return investments with existing managers in good standing, an individual commitment in addition to the existing commitments, up to 10% of the target allocation to the total AR Portfolio or \$50 million (whichever is lesser).

C. Staff

Staff shall be responsible for oversight and administration of ACERA's AR Portfolio. Staff's responsibilities shall include, but not be limited to the following:

1. Developing and recommending all necessary changes to the AR Policy with input from Consultant;
2. Developing and maintaining specific procedures, if necessary, to comply with the approved AR Policy with input from Consultant;
3. Developing the investment plans of ACERA's AR Portfolio and making recommendations to the Investment Committee for adoption with input from Consultant;
4. Delegation:
 - a. Approving Consultant's Absolute Return investment proposals (new proposals) with each individual commitment up to 5% of the target allocation to the total AR Portfolio or \$25 million (whichever is lesser) upon completion of a thorough review and due diligence process with satisfactory results. Staff and Consultant shall provide the Investment Committee all required reports (please see Appendices I through III).
 - b. Approving Consultant's Absolute Return investment proposals for "re-ups" with existing managers with each individual commitment in addition to the existing commitments, up to 10% of the target allocation to the total AR Portfolio or \$50 million (whichever is lesser) to managers in good standing⁷ upon completion of a thorough review and due diligence process with satisfactory results. Staff and Consultant shall provide the Investment Committee all required reports (please see Appendices I through III).
5. Through the Investment Products and Services Introduction (IPSI) program of ACERA, and with the concurrence of the Consultant, recommend highly qualified AR investments

⁶ Investment manager may not appear before the Investment Committee in circumstance when Staff has exercised its delegated authority.

⁷ An investment manager may be considered to be in good standing if there is sufficient comfort with factors including, but not limited to, its organization, strategy, performance, and compliance.

- to the Investment Committee upon completion of a thorough review and the due diligence process, and providing the required reports listed in the Appendix I of this AR Policy to Staff and/or the Investment Committee. (Please see Appendices I through III);
6. Monitoring the AR Portfolio for performance and compliance with the AR Policy;
 7. Monitoring the performance of the underlying Investment Managers and their compliance with a) the investment guidelines as set forth in their respective contracts; b) this AR Policy; and c) applicable requirements of ACERA's General Investment Guidelines, Policies and Procedures;
 8. Conducting comprehensive reviews of ACERA's AR Portfolio and the individual investments in the Portfolio;
 9. Reporting to the Investment Committee any violations of the AR Policy with appropriate recommendations;
 10. Assisting ACERA's legal department in contract negotiations with the selected Investment Managers;
 11. Evaluating Absolute Return investment opportunities with Consultant's input on an ongoing basis; and
 12. Evaluating and making recommendations for retention, additions to, and termination of Investment Managers.

D. Consultant

The Consultant hired by the Board is a fiduciary to ACERA and its Board. Consultant shall independently and continuously monitor and analyze the performance of ACERA's AR Portfolio and make related recommendations to serve the best interests of the plan participants. Consultant shall assist Staff in developing the AR Policy and recommending all necessary changes to the AR Policy. In addition, Consultant shall be responsible for:

1. Analyzing the asset allocation of the AR Portfolio by type, implementation vehicle, and underlying strategies, and making recommendations for reallocation of assets, as appropriate;
2. Developing an investment plan for ACERA's AR Portfolio every 1 to 3 years;
3. Developing a search strategy for highly qualified Absolute Return investments and maintaining a robust database containing information on Investment Managers;
4. Recommending highly qualified Absolute Return fund investments to Staff and/or the Investment Committee upon completion of a thorough due diligence process and providing the required reports listed in the Appendix I of this AR Policy to Staff and/or the Investment Committee;
5. Ongoing monitoring of the investment performance of ACERA's AR Portfolio and individual investments in the Portfolio;
6. Conducting ongoing due diligence on Investment Managers, notifying ACERA of any significant developments and adverse events and providing analysis and advice on such issues;
7. Ongoing monitoring of Investment Managers' compliance with a) their respective investment guidelines as set forth in their contract; b) this AR Policy; and c) applicable requirements of ACERA's General Investment Guidelines, Policies and Procedures;
8. Assisting Staff in contract negotiations with the selected Investment Managers;

9. Submitting performance evaluation reports and conducting comprehensive reviews of the AR Portfolio and individual Investment Managers semi-annually, and when appropriate, quarterly to the Investment Committee;
10. Making recommendations for retention or termination of Investment Managers;
11. Attending meetings as needed; and
12. Performing other duties in accordance with the terms of its contract and applicable State and Federal law.

E. Investment Managers

Investment Managers are fiduciaries and shall prudently manage ACERA's assets in the best interest of ACERA and its members. Investment Managers shall abide by all applicable policies and procedures established by ACERA and fully comply with applicable law. Investment Managers shall be responsible for compliance with a) the specific investment guidelines as set forth in their respective contracts; b) this AR Policy; and c) applicable requirements of ACERA's General Investment Guidelines, Policies and Procedures. Investment Managers shall be responsible for all aspects of portfolio management as set forth in their respective contracts with ACERA. They shall also:

1. Communicate with Staff and/or Consultant promptly regarding investment strategy, investment results, and any non-conforming issues that may have significant and/or negative impact on the portfolio;
2. Cooperate fully with Staff, Consultant, ACERA's custodian, and other ACERA vendors concerning requests for information;
3. Submit reports to Staff and Consultant in accordance with their contract terms; and
4. Attend meetings as needed.

IX. DUE DILIGENCE PROCESS: ABSOLUTE RETURN INVESTMENT SELECTION

ACERA recognizes that a proper due diligence process is essential to control the risks associated with AR investments and, therefore, hereby establishes the following due diligence processes for both its Consultant and Staff:

A. Consultant

Consultant shall conduct extensive, documented due diligence before making any Absolute Return investment recommendations to Staff and the Investment Committee. Consultant shall involve Staff in the due diligence process, as necessary. When appropriate, Consultant shall, but not be limited to:

1. Assessing the reputation of the individuals who manage the Absolute Return investments, consider background checks, and in-person meetings or conference calls with these individuals, etc.;
2. Conducting on-site visits to the offices of the Investment Managers;
3. Checking references when appropriate from other investors that have invested in these Absolute Return investments, and, when advisable, from competitors;
4. Determining that the Absolute Return investment funds are audited, at least annually, by a reputable and nationally recognized external independent auditing firm;

5. Reviewing Investment Managers investment strategies, policies, operating procedures, and historical performance;
6. Analyzing attribution of historical returns and main return drivers of each strategy, as well as analyze the suitability of each investment for ACERA's AR Portfolio.
7. Reviewing business terms of all legal agreements and other related documents for the Absolute Return investments under consideration, such as offering memorandum, legal agreements, and Forms ADV;
8. Reviewing the investments for potential exposure to Unrelated Business Taxable Income (UBTI); and
9. Assessing what exit strategies exist to liquidate existing investments owing to poor performance or other threat to the investment (e.g. fraud and weak fund accounting procedures) and, if necessary, to avoid future investments in similar funds.

B. Staff

Staff shall ensure that Consultant has conducted extensive, documented due diligence on all Absolute Return investment proposals recommended to Staff and the Investment Committee. Staff shall participate in Consultant's due diligence process when appropriate, shall conduct its own independent due diligence, and shall also be responsible for:

1. Reviewing the comprehensive analysis report prepared by Consultant on its recommended Absolute Return investments;
2. Verifying the compliance of each recommended Absolute Return investment with the AR Policy, the investment plans for ACERA's AR Portfolio and other applicable investment policies;
3. Discussing all issues related to the recommended Absolute Return investments with Consultant and with Investment Managers to gain a thorough understanding of each strategy's primary return drivers, key terms, and investment guidelines, and determine the investment's suitability for ACERA's AR Portfolio; ~~and~~
4. Performing independent due diligence regarding the business, economic, and legal aspects of the proposed AR investment and in accordance with the Executive Summary (Appendix II) and the Compliance Checklist (Appendix III); ~~;~~
5. Completing Appendices II and III of this document for each proposal; ~~;~~
6. Conducting an on-site due diligence visit to each manager's headquarters office whenever possible; and
7. Arranging presentations of select investment opportunities to the Investment Committee as described under Section VIII.C.4.

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X. SPECIFIC PERFORMANCE EVALUATION CRITERIA

When appropriate, the specific performance evaluation criteria, including but not limited to benchmarks, for Investment Managers will be established in the investment agreements between ACERA and individual Investment Managers.

XI. MONITORING AND REPORTING

Consultant and Staff will closely monitor and analyze the AR Portfolio so that the strategic objective of the Portfolio can be met.

Investment Managers shall submit all reports to Staff, Consultant, ACERA's custodian, and other ACERA vendors in accordance with their respective contracts.

Consultant shall submit all reports to Staff in accordance with its contract terms and the AR Policy.

Consultant, in conjunction with Staff, shall perform evaluations of ACERA's AR Portfolio and the underlying Investment Managers semi-annually and, when appropriate, quarterly. Consultant shall report the findings to Staff and the Investment Committee.

XII. ABSOLUTE RETURN INVESTMENT INFORMATION DISCLOSURE POLICY

ACERA is a public agency subject to state laws, including, without limitation, (a) the California Public Records Act (Cal. Govt. Code §6250, *et seq.*)(the "Public Records Act"), which provides generally that all records relating to a public agency's business are open to public inspection and copying unless exempted under the Public Records Act, (b) the Ralph M. Brown Act (Cal. Govt. Code § 54950 *et seq.*)(the "Brown Act"), which provides generally for open meetings for local legislative bodies, and (c) the California Government Code Section 7514.7 ("Cal. Govt. Code § 7514.7") which provides generally that public pension systems in California obtain and publicly disclose certain information regarding fees, expenses and returns from the alternative investment vehicles in which they invest. (*See* Appendix IV for details of the ACERA disclosure policy regarding its Absolute Return investments.)

XIII. TABLE OF AMENDMENT DATES

September 21, 2017

[July 15, 2021](#)

Appendix I

List of Reports Required for Each Investment Recommendation/Approval

Name of Report	Source
Recommendation/Approval memo	Staff
Recommendation/Approval memo	Consultant
Executive Summary of the Fund	Consultant/Staff
Compliance Checklist	Staff
Comprehensive Due Diligence Report (available to Trustees upon request)	Consultant
Manager Pitchbook	Investment Manager

Note: Staff will provide an abbreviated Executive Summary Report that is available for review upon request by the Trustees.

Appendix II

Executive Summary Report Template

Fund Name

Section I: General Information

Fund Name; Total AUM of the Firm; Total AUM in Strategy; Strategy Vehicles available; -Fund Focus; etc.

Section II: Investment Management

Organization Structure; Management Group; Experience; Personnel Turnover; etc.

Section III: Investment Strategy

Investment Philosophy; Investment Strategy; Investment Process; Investment Objective; Key Investment Return Drivers; etc.

Section IV: Risk Management

Risk Control Methodology; Exit Strategy; etc.

Section V: Investment Rationale

Section VI: Investment Concerns

Section VII: Performance (example)

Benchmark:

Net Returns (%):

Periods Ending Date	YTD	1Year	3Years	5Years	Since Inception
Fund					
Benchmark					
Relative Performance: Account – Benchmark					

Section VIII: Key Terms

Fund Terms; Incentive Fees; Management Fees; Other Fees; Capacity (if relevant); Lock Ups; Redemption Provisions; etc.* List of items to be addressed as appropriate. Data provided by Name as of Date; ICM Date

<p>limited to, long/short equity, event driven, convertible arbitrage, relative value, market neutral, fixed income arbitrage, macro, and other strategies. Can also include liquid, broadly diversified direct hedge funds.</p> <p><u>Other Alternatives/Opportunistic</u>: a wide range of innovative, uncorrelated and/or non-traditional investments that fall outside of previously identified asset classes and contribute to the overall return and diversification of the Alternatives Portfolio. Includes currency, interest in equity and revenue of managers, and other uncorrelated approaches.</p> <p>Alternatives may be denominated in U.S. dollars or other currencies.</p>	<p><i>Specific currency denomination.</i></p>	<p><i>Yes, No or N/A</i></p>
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4. Return Expectation

<p>HFRI Fund of Funds Composite Index (net of all fees and expenses) over a market cycle</p>	<p><i>Specific return target.</i></p>	<p><i>Yes, No, or N/A</i></p>
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5. Investment Correlation to Equities

<p><u>Absolute Return Portfolio</u>: In aggregate, the Alternatives Portfolio is expected to have a return correlation to equities of ≤ 0.5, on average, and should not have a correlation to equities that exceeds that of the HFRI FOF Composite Index.</p>	<p><i>Does the addition of this investment cause the aggregate correlation of the Absolute Return Portfolio to have a return correlation to equities of ≤ 0.5 or a correlation to equities that exceeds that of the HFRI -FOF Composite Index?</i></p>	<p><i>Yes, No, or N/A</i></p>
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6. Investment Allocations

<p><u>Absolute Return -Portfolio</u>: range 4%-</p>	<p><i>Actual allocations to the Absolute Return</i></p>	<p><i>Yes, No, or N/A</i></p>
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<p>10.05% of the total Fund. AP: target 50%; range 20%-70%. FOHF: target 480%; range 250%- 70100%. Other Alternatives/Opportunistic: target 120%; range 0%-50%.</p>	<p><i>Portfolio and the underlying portfolios including specific commitment to the Investment Manager.</i></p>	
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7. Investment Constraints

<p>AP Investments: Target 25% of the target value of the AR Portfolio; range 10% - 30%.</p> <p>FOHF Investments: Target 240% of the target value of the AR Portfolio; range 10%- 450%.</p> <p>Other Alternative Investments/Opportunistic Investments: Maximum 25% of the target value of the AR Portfolio.</p>	<p><i>Specific commitment to the Investment Manager.</i></p>	<p><i>Yes, No or N/A</i></p>
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B. Absolute Return Investment Plan for YEAR

Approved: *DATE*

Fund Name

In Compliance

<p>Specific Investment Plan</p>	<p><i>Specific commitment to the Investment Manager.</i></p>	<p><i>Yes, No or N/A</i></p>
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APPENDIX IV

Details of Disclosure Policy For Absolute Return Investments (“AR Funds”)

1. Upon request, ACERA shall disclose : (i) the name, address and vintage year of each AR Fund; (ii) the dollar amount of capital committed to each AR Fund by ACERA since inception; (iii) the dollar amount of cash contributions made to each AR Fund by ACERA since inception; (iv) the dollar amount of distributions received by ACERA from each AR Fund on a fiscal yearend basis; (v) the market value of ACERA’s investment in each AR Fund on a fiscal yearend basis; (vi) each AR Fund’s net internal rate of return (“IRR”) since inception; (vii) the investment multiple of each AR Fund since inception; (viii) the dollar amount of total management fees and expenses paid on an annual fiscal yearend basis, by ACERA to each AR Fund; and (ix) the dollar amount of cash profit received by ACERA from the AR Fund on a fiscal yearend basis. (*See* Cal. Govt. Code § 6254.26(b).)

2. ACERA shall disclose at least once annually in a report presented at a meeting open to the public : (i) the fees and expenses that ACERA pays directly to the AR Fund, the AR Fund manager or related parties; (ii) ACERA’s pro rata share of fees and expenses not included in (i) that are paid from the AR Fund to the AR Fund manager or related parties; (iii) ACERA’s pro rata share of carried interest distributed by the AR Fund to the AR Fund manager or related parties; (iv) ACERA’s pro rata share of aggregate fees and expenses paid by all of the portfolio companies held by the AR Fund to the AR Fund manager or related parties; (v) the information outlined in Section 1, above, and (vi) the gross and net IRR of the AR Fund, since inception. (*See* Cal. Govt. Code § 7514.7.)

All other records regarding such Absolute Return investments shall be exempt from disclosure to the fullest extent permitted under applicable law.

Notwithstanding the preceding, or anything else in this Policy, ACERA reserves the right to withhold any record when “on the facts of the particular case the public interest served by not disclosing the record clearly outweighs the public interest served by disclosure of the record.” (*See* Cal. Govt. Code §6255(a).) This weighing process contemplates a case-by-case balancing test

between competing public interests based on the facts presented as the statute has been interpreted by the courts.⁸

⁸ *Michaelis, Montanari & Johnson v Superior Court*, 38 Cal.4th 1065, 1071 (2006).



TO: Members of the Investment Committee
FROM: Clint Kuboyama, Investment Officer *Clint Kuboyama*
DATE: July 14, 2021
SUBJECT: Report on the Proposed Timeline, Search Criteria, and Evaluation Matrix for ACERA's Absolute Return (Custom Fund of Hedge Funds¹) Manager Search

Recommendation:

N/A – this is an information item.

Summary:

On April 15, 2021, the ACERA Board approved a structural change to the Absolute Return (AR) Asset Class that is 80% Fund of Hedge Funds/20% Other Alternatives/Oppportunistic. The 80% Fund of Hedge Funds (FOHF) allocation is being implemented with two customized FOHF managers at 40% portfolio weightings each. ACERA currently has one custom FOHF manager, Lighthouse, and, in order to implement the new AR Asset Class structure, Staff and Verus are now searching for a second custom FOHF manager. The second custom FOHF manager is expected to complement the existing customized FOHF manager, along with the other investment exposures in the AR Portfolio and help the AR Asset Class reach its investment performance goals. Staff and Verus recommend a focused-list search to hire a manager for this mandate. Through this information item, Staff and Verus propose the disclosed focused list search methodology, as well as the search's Timeline (Attachment #1), Minimum Qualifications (Attachment #2), and Evaluation Matrix (Attachment #3). The intention of this information item is to propose the search plan, receive the Investment Committee's (IC's) feedback, and integrate this feedback into the final search proposal, which is expected to be brought before the IC in August 2021 as an action item.

Background:

Creation of the Proposed Initial Manager Universe: After the April 15, 2021 Board approval of the new AR Asset Class structure, Staff was contacted by eleven FOHF managers. Four of these managers are existing managers in ACERA's Total Fund (Blackstone, BlackRock, UBS, and K2, a subsidiary of Franklin Templeton) while one was previously a manager in ACERA's Total Fund (Entrust Global). Seven managers introduced their FOHF offerings to Staff via ACERA's Investment Products and Services Introductions (IPSI) program (UBS, Grosvenor, Goldman Sachs, Man FRM, Aksia, Morgan Stanley, and New Holland). Staff and Verus subsequently held introductory calls between May 18 and June 8 with these eleven managers to assess the FOHF landscape and gain an understanding of the managers' FOHF investment platforms, including their ability to customize portfolios to meet ACERA's needs. A twelfth manager (Bainbridge Partners) submitted its platform for consideration via an IPSI submission on June 28, but was not met with due to its late submission.

Prospective managers also contacted Verus to express interest in ACERA's FOHF search (Aurum) or were referred to Verus for consideration (Aberdeen). Finally, Verus had previously conducted research on, and was comfortable with, six managers to be considered for this mandate (Abbey, Aetos, Corbin, Efficient, Evanston, and Magnitude).

Since mid-April, Staff and Verus have collaboratively discussed the search and process to create the initial manager universe. The collective conclusion was that FOHF manager databases would not provide sufficient information to

¹ A custom fund of hedge funds is also known as a "Hedge Fund of One" and is referred to as such in the proposed Minimum Qualifications (Attachment #2) and Evaluation Matrix (Attachment #3).

determine whether a manager could provide the appropriate custom, fund-of-hedge-funds services to ACERA; these databases typically only have performance data for a manager's flagship commingled fund of hedge funds, which typically have a higher return correlation to global equities than what ACERA is searching for in this mandate. In addition, when reviewing the list of managers mentioned above, Staff and Verus believed that the collection of managers, all with the ability to provide customized solutions and which range from some of the largest and most experienced FOHF managers globally to smaller, specialized managers, could serve as a useful initial manager universe to begin the search process with. Accordingly, Staff and Verus recommend using this list of twenty managers as the initial manager universe.

Creation of Focused List: Should the IC be comfortable with this initial manager universe, Staff and Verus plan to send each of these managers an initial, "screening" questionnaire soon after the conclusion of this IC meeting. (Please see Attachment #1 for the proposed Timeline of the various steps proposed for this search.) The screening questionnaire, along with the Minimum Qualifications (please see Attachment #2) are anticipated to evaluate each manager's platform for its suitability to meet ACERA's needs. The screening questionnaire will request information on AUM (commingled FOHF, custom FOHF accounts and strategies similar to ACERA's risk/return objectives), along with risk and performance statistics. Based on the evaluation of the screening questionnaire responses and the Minimum Qualifications, Staff and Verus will create a narrowed, focused list of managers.

Evaluation of Focused List Managers: Focused list managers will be sent a second, "comprehensive" questionnaire. This comprehensive questionnaire will enable a deeper look into each manager's suitability to meet ACERA's needs. Staff and Verus anticipate scoring the responses to these comprehensive questionnaires based on the proposed Evaluation Matrix (see Attachment #3). Based on the scoring, Staff and Verus will create a finalist list of candidates that extensive due diligence, including on-site visits (assuming travel is allowed), will be conducted on. Following this diligence, Staff and Verus anticipate rescoring the finalist managers with the proposed Evaluation Matrix.

Recommendation(s) Evaluated by IC: Based on the proposed search Timeline, Staff and Verus plan on proposing a single or multiple recommendation(s) to the IC for the IC's evaluation. In past searches, Staff and Verus have typically proposed multiple managers for the IC's evaluation and Staff and Verus can continue this practice if advised by the IC to do so. However, should there be a manager that is clearly above the other candidates, Staff and Verus request the flexibility to only recommend one manager to the IC for approval. This one manager recommendation process would also be similar to the typical IC recommendation process for private markets managers.

Conclusion:

Staff and Verus propose the search process outlined above, as well as the attached Timeline, Minimum Qualifications, and Evaluation Matrix, for ACERA's custom fund of hedge funds search. Staff and Verus seek the IC's input on each such that the process can be finalized at the following August IC and Board meetings and the search can thereafter commence.

Attachment:

- #1 Proposed Timeline, prepared by Staff
- #2 Proposed Minimum Qualifications, prepared by Staff
- #3 Proposed Evaluation Matrix, prepared by Staff
- #4 Verus Custom Fund of Hedge Funds Manager Search Overview, prepared by Verus

Attachment I

ACERA – CUSTOM FUND OF HEDGE FUNDS MANAGER SEARCH

Proposed Timeline

ⁱStep	Activity	Tentative Deadline	Status
1.	Staff and Verus develop Initial Manager Universe, Screening Questionnaire, Timeline, Minimum Qualifications, and Evaluation Matrix	7/14/21	Completed
2.	Search Process, Timeline, Minimum Qualifications, and Evaluation Matrix to be discussed with Investment Committee as an Information Item	7/14/21	In Process
3.	Send Screening Questionnaire to Initial Manager Universe	7/15/21	Yet to Start
4.	Screening Questionnaire Responses Due	7/22/21	Yet to Start
5.	Evaluate Screening Questionnaire Responses and Create Search Focused List	7/29/21	Yet to Start
6.	Finalize Timeline, Minimum Qualifications, Evaluation Matrix, and Comprehensive Questionnaire (questionnaire to be sent to Focused-List Managers on 8/20/21)	8/11/21	Yet to Start
7.	Timeline, Minimum Qualifications and Evaluation Matrix to the Investment Committee and Board as Action Items for Approvals	8/11/21 IC 8/19/21 Board	Yet to Start
8.	Send Comprehensive Questionnaire to Search Focused List	8/20/21	Yet to Start
9.	Comprehensive Questionnaire Response Deadline for Focused List Managers	9/17/21	Yet to Start
10.	Staff and Verus Evaluation of Comprehensive Questionnaire Responses	10/15/21	Yet to Start
11.	Staff and Verus Create Finalist List	10/15/21	Yet to Start
12.	Staff and Verus Perform Due Diligence and On-Site Visits with Finalists	11/12/21	Yet to Start
13.	Present Search Recommendation(s) for Investment Committee and Board Approvals	12/8/21 IC 12/16/21 Board	Yet to Start

ⁱ Deadlines are subject to change based upon time and resources required to complete the evaluation process.

Attachment II

ACERA – CUSTOM FUND OF HEDGE FUNDS MANAGER SEARCH

Proposed Minimum Qualifications

1. The Firm must agree to act as a fiduciary to ACERA.
2. The Firm must be registered as an investment adviser under the Investment Advisers Act of 1940, a bank (as defined in that Act) or an insurance company qualified to perform investment management services under state law in more than one state, including the State of California.
3. ACERA's investment account should not comprise more than 10% of the Firm's total assets under management at any time.
4. The Firm must have a minimum ten years' experience managing discretionary, commingled fund-of-hedge-funds and/or custom, discretionary hedge-fund-of-one¹ portfolios.
5. The Firm must have a minimum of \$3.5 billion in discretionary, commingled fund-of-hedge-funds and/or custom, discretionary hedge-fund-of-one assets under management.
6. The Firm must manage at least three custom hedge-fund-of-one portfolios that are in excess of \$100 million in size. Prefer firms with at least one custom hedge-fund-of-one portfolio that is \$350 million in size or greater.
7. The Firm must be able to provide ACERA management fees, performance fees, and pass-through fees at the aggregate underlying manager level and at the fund-of-hedge-funds-portfolio level, as well as gross and net return on a quarterly basis.
8. The Firm must be willing to annually complete ACERA's ESG questionnaire that discloses the Firm's ESG initiatives and factors incorporated at the organization and within the investment process.
9. ACERA prefers, but does not require, firms that have the ability to include compelling emerging (smaller and newer) hedge funds as part of the custom, hedge-fund-of-one portfolio.
10. The Firm should carry the following minimum insurance coverage or should apply for it by contract execution²:
 - a. Commercial General Liability – \$4,000,000
 - b. Crime Coverage
 - i. Employee Dishonesty Coverage - \$10,000,000
 - ii. Computer Theft Coverage - \$1,000,000
 - c. Error and Omissions (Professional Liability) - \$10,000,000
 - d. Fiduciary Liability - \$25,000,000, or 10% of the total assets managed in the ACERA account, whichever is higher, unless the proposed contract specifies otherwise
 - e. Workers' Compensation and Employer's Liability - \$1,000,000
11. Attend ACERA's Investment Committee Meetings as needed.
12. The Firm must be willing to allow ACERA to review the latest 3-5 years of the Firm's audited financial statements.
13. Once selected by ACERA as the recommended Firm, the Firm must consent to a background investigation of the investment management entity and key individuals.

¹ Custom fund of hedge funds are also known as "Hedge Fund of Ones".

² Subject to change upon final contract negotiation.

Attachment III

ACERA – CUSTOM FUND OF HEDGE FUNDS MANAGER SEARCH

Proposed Evaluation Matrix

A.	Fund of Hedge Funds Organization	10 Points
	<ol style="list-style-type: none">1. History2. AUM in discretionary fund of hedge funds3. AUM in customized, discretionary hedge fund of ones¹4. Access to resources from broader organization5. Proprietary strategies6. ESG initiatives	
B.	Investment Team	15 Points
	<ol style="list-style-type: none">1. Experience/Quality/Tenure of Decision Makers<ol style="list-style-type: none">i. Manager evaluationii. Portfolio constructioniii. Portfolio managementiv. Risk management2. Team Structure/Team Alignment of Interests	
C.	Investment Process	17.5 Points
	<ol style="list-style-type: none">1. Manager sourcing/access to managers2. Evaluation of managers/strategies3. Manager/strategy approval process4. Portfolio construction5. Portfolio management6. ESG integration	
D.	Risk Management	17.5 Points
	<ol style="list-style-type: none">1. Investment risk2. Operational risk3. Independent risk management division	
E.	Performance	15 Points
	<ol style="list-style-type: none">1. Flagship fund and/or custom account composite<ol style="list-style-type: none">i. Risk-Adjusted Returnsii. Downside captureiii. Correlation and beta to global markets	
F.	Platform Flexibility/Ability to Meet ACERA’s Needs	15 Points
	<ol style="list-style-type: none">1. Portfolio liquidity options2. Fee/performance transparency3. Engagement/value add to ACERA Staff/Consultant	
G.	Management/Performance Fees	10 Points
	<ol style="list-style-type: none">1. Portfolio-level management fee proposal2. Underlying manager/strategy management and performance fees<ol style="list-style-type: none">i. % managers on platform with reduced fees<ol style="list-style-type: none">a. Average management fee discountb. Average performance fee discount	

¹ A custom fund of hedge funds is also known as a “Hedge Fund of One”.

Memorandum

To: ACERA
From: Verus
Date: July 14, 2021
RE: Custom fund of hedge funds manager search overview

Executive Summary

ACERA will be conducting a custom fund of hedge funds manager search as a result of the Plan's recent absolute return structure change whereby alternative premia strategies will be taken out of the absolute return portfolio and replaced with an additional custom fund of hedge funds manager. This upcoming change will be made to increase alpha potential in this part of the portfolio while maintaining a similar risk profile and to allow the absolute return portfolio to be more adaptable to changes in the market environment.

This memo outlines the search process that we plan on using for the custom fund of hedge funds search with rationale behind it. We would like to elicit feedback from the Trustees and revise as needed prior to returning in August with a proposed action item to begin the search.

Target Allocation

The absolute return ("AR") portfolio has the strategic objective of 1) generating superior returns commensurate with risk taken using strategies that have a low correlation to the global equity markets; 2) enhancing ACERA's long-term risk-adjusted return and providing additional diversification to ACERA's overall investment Fund; and 3) generating total AR Portfolio returns at or above the HFRI Fund of Funds Composite Index, net of all fees and expenses.

ACERA's new AR target allocation as of April 2021 is shown below. In addition, ACERA revised its overall strategic asset allocation in June 2021 which reduced the AR weighting from 9% to 8% of the total portfolio which is also reflected in the table. The actual weighting to AR is slightly lower than that at approximately 7% of the overall portfolio at this time.

Sub-categories	Target Allocations	Min./Max. Ranges (total portfolio %)
Absolute Return Portfolio	8.0%	4% to 10%
<ul style="list-style-type: none"> ▪ <i>Fund of hedge funds</i> ▪ <i>Other Alternatives/Opportunistic</i> 	<ul style="list-style-type: none"> 80% 20% 	<ul style="list-style-type: none"> 50% to 100% 0% to 50%

Most of the AR portfolio based on target allocations will be comprised of fund of hedge funds assets, which are customized versions of off-the-shelf hedge fund-of-funds vehicles. This diversified source of hedge fund exposure allocates to underlying hedge funds with decisions and oversight delegated to a hedge funds-of-funds manager who manages the portfolio in accordance with ACERA's specified investment objectives and guidelines. This portion of the

AR portfolio seeks return primarily through exploiting idiosyncratic alpha sources (as opposed to returns driven by market beta).

Other alternatives/opportunistic absolute return strategies seek to augment this diversified exposure with other alpha-oriented strategies that are uncorrelated with public markets. These investments can include a wide range of innovative and/or non-traditional investments that offer unique attributes that should further contribute to the overall return and diversification objectives of the AR Portfolio. This portion of the portfolio can be described as incorporating “best ideas”, uncorrelated approaches.

We estimate a five-month process from the time the search is initiated to Board approval of the new manager.

Manager Search Process Overview

ACERA’s AR portfolio is intended to generate stable, modest, positive returns that are uncorrelated with global equity markets (i.e., not dependent on broad market movements for alpha). While return targets for AR are muted compared to long only equity strategies, higher risk-adjusted returns are expected with lower volatility and less downside risk. The role of absolute return is offer diversification both at the total return portfolio level and within lower volatility strategies (i.e., a fixed income substitute). Quantitative metrics in the search process will focus on these elements.

As described above, ACERA has elected to add to a fund of hedge funds via a customized portfolio to increase alpha potential in AR and to provide greater flexibility to react to market movements and opportunities while explicitly adhering to ACERA’s AR investment objectives. Attractive attributes of the hedge fund-of-funds approach include:

- Specialist professional management oversight and deep resources
- Diversification and reduction of manager specific risk
- Broad knowledge of the hedge fund industry and landscape
- Outsourcing of tactical investment decisions among underlying hedge fund strategies
- Robust analytical, technological, and reporting infrastructure, leading to increased transparency and ability to manage risk more quickly
- Operational due diligence capabilities
- Potential for fee negotiation with underlying managers
- Potential access to capacity to closed and/or emerging managers, and
- Education and an additional sounding board should ACERA determine to evolve its program in the future.

Verus and ACERA staff are proposing a focused list search with two questionnaires. The first is a preliminary questionnaire sent to providers that Verus and ACERA Staff have identified as potential managers for the mandate. While there is robust fund of hedge funds manager universe, third party data on this universe tends to be spotty and some well-known providers opt out of disclosing data to third party sources. For this reason, a short questionnaire focusing on current data and firm and strategy statistics will enable us to compare the managers on various metrics as outlined in the minimum qualifications.

Verus and ACERA staff will then review and compare the responses and send a detailed questionnaire to a subset of these managers (i.e., managers on the focused list). Our due diligence process will focus on assessing the responses and analyzing return and risk-adjusted performance from these providers. We will utilize comprehensive broad evaluation criteria on the firm and its hedge fund experience, investment team experience, approach to manager due diligence (sourcing, manager analysis on the investment and operational fronts), portfolio construction, risk management, customization experience, performance (return, risk and risk-adjusted analysis), ability to offer improved transparency and reduced fees.

Verus and ACERA Staff then propose determining a short list of managers to visit (COVID willing) following review of the detailed questionnaires with the finalist presentation taking place by year-end. Note that Verus and ACERA Staff reserve the right to recommend one finalist should our joint analysis point to one provider we believe is best suited for the mandate. While different from historical public markets searches at ACERA, this is in line with the typical search process for alternatives searches.

Summary

Verus and ACERA Staff propose using the search process outlined above for identification of an optimal custom fund of hedge funds manager to implement ACERA's new approved absolute return structure. As described above, our goal is to identify a qualified manager with ample experience in hedge fund manager due diligence, portfolio construction and customization. We are striving to ensure that the manager has experience with custom fund of hedge funds in the range of ACERA's proposed allocation yet still allow for the consideration of compelling, boutique firms in the search process outside of the largest providers. Transparency and competitive fees are other important criteria in the search process.

We seek Trustee feedback so that we can return next month with appropriate final search criteria and initiate the manager search in August.

Past performance is no guarantee of future results. This document is provided for informational purposes only and is directed to institutional clients and eligible institutional counterparties only and is not intended for retail investors. Nothing herein constitutes investment, legal, accounting or tax investment vehicle or any trading strategy. This document may include or imply estimates, outlooks, projections and other "forward-looking statements." No assurance can be given that future results described or implied by any forward looking information will be achieved. Investing entails risks, including possible loss of principal. Verus – also known as Verus Advisory™.