Ohio Public Employees Retirement System

Hedge Funds Policy
September 2019

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Revision History

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I. SCOPE

This Policy applies to investments in the Hedge Funds sub-asset class by the Ohio Public Employees Retirement System ("OPERS") Defined Benefit Fund ("DB Fund") and Health Care 115 Trust Funds ("HC Fund").

II. PURPOSE

This Policy provides the broad strategic framework for managing the Hedge Funds sub-asset class.

III. INVESTMENT PHILOSOPHY

Hedge fund investments are structured to preserve capital and provide competitive returns with a low correlation to traditional asset classes, offering diversification and reduced volatility of plan returns.

IV. ALLOCATION

The allocation to the Hedge Funds sub-asset class is specified in the Investment Objectives and Asset Allocation Policy for the DB and HC Funds. Investments within the Hedge Funds sub-asset Class may be made across multiple asset classes. For asset allocation measurement purposes, those exposures are only reflected within the Hedge Funds allocation.

Hedge fund investments may also be used in portfolios other than those within the Hedge Funds sub-asset class in order to achieve portfolio-specific objectives. In these instances, the hedge fund investments shall be incorporated into the Hedge Funds sub-asset class for asset allocation purposes. These investments will be excluded from provisions of the Hedge Funds Policy specific to the Hedge Funds sub-asset class including Section VII and Section VIII.

V. PERMISSIBLE INSTRUMENTS

Investments in hedge funds may include equity hedge, event driven, relative value and macro/tactical, and hedge fund beta/replication strategies.

Investments in each fund will be governed by the hedge fund's legal documents and side letters or investment guidelines in the case of separate accounts.

VI. THIRD-PARTY MARKETING

OPERS expects its general partners to behave legally and ethically. OPERS requires that third-party marketers used by general partners be regulated by appropriate legal authorities and subject to disciplinary actions by them. OPERS will confirm in its side letter, investment management agreement or other contractual arrangement, that a manager being engaged by OPERS has a requirement to provide the details of marketing arrangements, political contributions, or similar payments involving individuals, placement agents, third-party marketers and the like with respect to OPERS investments with the manager.

VII. STRUCTURE

Investments in the Hedge Funds sub-asset class are diversified by manager and strategy in order to reduce the impact from any one strategy being out of favor. Strategy diversification will be monitored by Investment Staff (“Staff”) and included on quarterly reports. The market value range for each strategy held within the sub-asset class is as follows:

Strategy	Range
Equity Hedge	0-15%
Event Driven	0-40%
Relative Value	0-50%
Macro/Tactical	0-50%

Staff, in conjunction with the Due Diligence Consultant, will classify each hedge fund investment within the Hedge Funds sub-asset class based on the following strategy descriptions:

A. Equity Hedge

Equity hedge strategies maintain positions both long and short in primarily equity and equity derivative securities. A wide variety of investment processes can be employed to arrive at an investment decision, including both quantitative and fundamental techniques; strategies can be broadly diversified or narrowly focused on specific sectors and can range broadly in terms of levels of net exposure, leverage employed, holding period, concentrations of market capitalizations and valuation ranges of typical portfolios.

B. Event Driven

Event driven managers maintain positions in companies currently or prospectively involved in corporate transactions of a wide variety including but not limited to mergers, restructurings, financial distress, tender offers, shareholder buybacks, debt exchanges, security issuance or other capital structure adjustments. Security types can range from most senior in the capital structure to most junior or subordinated, and frequently involve additional derivative securities.

Event driven exposure includes a combination of sensitivities to equity markets, credit markets and idiosyncratic, company specific developments. Investment insights are typically predicated on fundamental characteristics (as opposed to quantitative), with the realization of the thesis predicated on a specific development exogenous to the existing capital structure.

C. Relative Value

Relative value managers maintain positions in which the investment thesis is predicated on the realization of a valuation discrepancy in the relationship between multiple securities. Managers employ a variety of fundamental and quantitative techniques to establish investment insights, and security types range broadly across equity, fixed income, derivative or other security types. Fixed income strategies are typically quantitatively driven to measure the existing relationship between instruments and, in some cases, identify attractive positions in which the risk adjusted spread between these instruments represents an attractive opportunity for the investment manager.

D. Macro/Tactical

Macro/Tactical managers trade a broad range of strategies in which the investment process is predicated on movements in underlying economic variables and the impact these have on equity, fixed income, hard currency, and commodity markets. Managers employ a variety of techniques, both discretionary and systematic analysis, combinations of top down and bottom up disciplines, quantitative and fundamental approaches, or long and short term holding periods.

VIII. PERFORMANCE OBJECTIVES

The performance objective for the Hedge Funds sub-asset class is a custom benchmark using the HFRI single strategy indices weighted by the target allocations listed in the Annual Investment Plan.

IX. RISK MANAGEMENT

Risk is managed through a combination of quantitative and qualitative measures. Staff shall establish appropriate risk metrics for each hedge fund for risk measurement purposes. Proper risk management requires an adequate level of transparency from hedge funds into the underlying portfolios. Requirements include the following:

- All hedge funds must provide risk parameter and performance reporting on a monthly basis.
- Staff seeks advice from legal counsel, the Due Diligence Consultant and/or the Investment Advisor to determine if audited financial statements are required based on the specific structure of each investment.
- Staff establishes position-level transparency targets for the Hedge Funds sub-asset class.

A. Market Risk

The Hedge Funds sub-asset class is designed to have a low overall level of sensitivity to broad market risk factors such as equity markets, interest rates, and commodity prices. Risk management processes include the monitoring of risk factors at both the individual fund and Hedge Fund sub-asset class level.

B. Manager Risk

Staff may work with a Due Diligence Consultant and/or an Investment Advisor to identify hedge funds using a process approved by the Chief Investment Officer ("CIO"). In addition to the investment due diligence process, each hedge fund will undergo an operational due diligence review prior to funding to evaluate non-investment related risk factors. The allocation to each hedge fund manager in the Hedge Funds sub-asset class is limited as follows:

Fund Limit: 12% of the Hedge Funds sub-asset class market value

C. Liquidity Risk

Liquidity risk includes both the underlying holdings in a hedge fund and the provisions for making redemptions from the hedge fund. Redemption provisions will be evaluated for consistency with underlying security holdings in order to reduce the risk of forced selling of holdings at inopportune times caused by other investors in the hedge fund. Staff will monitor liquidity provisions of each individual hedge fund including lock-ups, gates, and withdrawal restrictions and report characteristics of the Hedge Funds Sub-Asset Class on a quarterly basis.

D. Leverage Risk

The use of leverage and the ability to short securities are intrinsic characteristics of hedge funds. Hedge fund managers may use leverage to implement their strategies and to control risk within the portfolio. Staff establishes an acceptable level for leverage at the Hedge Funds sub-asset class level and monitors leverage at both the individual hedge fund and total sub-asset class levels. Fund of hedge fund managers are not permitted to add leverage (in addition to that of the underlying hedge funds) without written consent from OPERS. The use of derivatives shall comply with OPERS Derivatives Policy.

Leverage can be defined in several ways and the measure will vary widely depending on the strategy and its associated liquidity, and by manager. Using a consistent leverage measurement basis that is considered to be market best practice, Staff expects the sub-asset class leverage to be a maximum level of 9 times.

Staff monitors sub-asset class and manager leverage monthly and uses other measures of leverage to provide a more complete understanding of the portfolio's sensitivities.

E. Legal Risk

Hedge funds have unique characteristics which require legal expertise including the use of outside counsel. Limitations include:

- Assets may only be invested in structures which limit losses to the amount invested.
- All managers exercising investment discretion must be (i) registered with the United States Securities and Exchange Commission or with a similar regulator if they are domiciled outside of the United States or (ii) a bank regulated by a United States regulatory body.

F. Active Risk

Active Risk or tracking error is a statistical measure of the potential variability of a portfolio’s return relative to that of the assigned benchmark. Hedge Funds does not lend itself to traditional quantitative measures of risk such as tracking error due to the use of a peer based index as a benchmark. The aggregate Hedge Funds Asset Class tracking error shall be evaluated over rolling three year periods and can range between 0 and 500 basis points.

X. ROLES AND RESPONSIBILITIES

A. OPERS Retirement Board

The OPERS Retirement Board ("Board") is responsible for reviewing and approving this policy and any changes to it.

In addition, the Board is responsible for reviewing reports related to this Policy.

B. Investment Staff

The Board delegates authority to the CIO to implement this Policy. Staff is responsible for monitoring the Policy and recommending changes to the Board.

Staff is also responsible for managing the hedge fund investments within the framework of the Board-approved Policies and within the goals and objectives adopted by the Board in the Annual Investment Plan.

C. Investment Compliance

The Investment Compliance area of Investment Accounting, Compliance & Risk ("IC") is responsible for monitoring compliance with this Policy, including guidelines established pursuant to it. If IC determines that an exception to this Policy has occurred, IC shall notify Staff, the CIO, the Executive Director and the Board.

D. Due Diligence Consultant

Staff hires a Due Diligence Consultant, who, at Staff's discretion, may assist with the public alternatives manager due diligence process, including identifying potential managers, conducting research on strategies, operational due diligence, and the ongoing monitoring of managers once they are hired. The Due Diligence Consultant serves an advisory role with Staff retaining investment discretion.

E. Investment Advisors

The roles of the Investment Advisors are specified in the Investment Objective and Asset Allocation Policies.

XI. MONITORING AND REPORTING

To ensure monitoring and compliance with this Policy, the following reports will be reviewed with the Board:

A. Quarterly

Performance reports – Investment Advisors and/or Staff

Report on compliance – Investment Compliance Staff

Report on liquidity – Staff

B. Annually

OPERS Annual Investment Plan – Staff