Investment Policy Statement for Absolute Return Investments

Approved by the Board of Trustees

Adopted: September 20, 2012

A. Introduction

The following investment policies govern the objectives, strategies, implementation, and performance measurement of the Absolute Return Program.

B. Investment Objective

The investment objective of the Absolute Return Program is to utilize a portfolio of hedge funds to achieve positive returns with a degree of independence from movements in equity and fixed income markets and independent of traditional performance benchmarks.

Hedge funds represent a distinctive investment style that is different from traditional, long-only funds. A fundamental difference is that hedge fund managers emphasize absolute, rather than relative returns, and they may also use a wider range of investment techniques, such as leverage, short selling and derivatives to achieve their objectives.

A portfolio of hedge funds is expected to deliver an absolute return with a risk level between that of stocks and bonds with a Sharpe ratio of 0.5 or better. The portfolio should also have a low correlation with other asset classes (i.e., 0.7 with stocks and 0.0 with bonds) and therefore help diversify the total fund portfolio. As such, the objective of the Absolute Return Program is to reduce the volatility of the total fund while continuing to maximize returns in a variety of market environments.

Given the above investment objectives, the performance of the Absolute Return Program will be compared against the following benchmarks:

- Over the long-term (trailing 5 year periods), performance of the Absolute Return Program is expected to exceed 3 month LIBOR by 500 basis points, net of fees and expenses.
- Over the short-term, performance of the Absolute Return Program is expected to exceed the HFRI Fund Weighted Composite Index[1], net of fees and expenses.

[1] HFRI Fund Weighted Composite Index is an equal weighted index that includes over 2,200 constituent hedge funds with at least $50 million under management or have been actively trading for at least twelve months. All funds report returns net of fees on a monthly basis.

C. Investment Guidelines

The investment policies and guidelines for the Absolute Return Program follow below.

1. **Hedge Fund Styles:** Investment is authorized in hedge funds that use a broad array of various hedge fund styles, including but not limited to:

    - *Market Neutral strategies* such as equity market neutral, fixed income arbitrage, and convertible bond arbitrage.
    - *Credit/distressed strategies* that typically invest in high yield bonds, bank loans, and structured credit products. Strategies may seek to take advantage of corporate securities in default, under bankruptcy protection, in distress or heading toward such a condition, or in liquidation.
    - *Event Driven strategies* that take advantage of transaction announcements and other one-time events, and includes merger arbitrage, spin-offs and restructurings.
    - *Equity long/short strategies* where there is combination of long and short positions primarily in publicly traded equities, with a net market exposure less than that of the overall equity market. Strategies may be focused on U.S., non-U.S., and/or specialty mandates.
    - *Global Macro strategies* such as all market portfolios, opportunistic long-only, managed futures, currency, dedicated short selling strategies or other specialty strategies. Strategies may include those that are classified as discretionary or systematic.
    - *Multi-strategies* where hedge funds invest using a combination of previously described strategies.

2. **Hedge Fund Investment Targets:** For the Absolute Return Program, the targeted and range of investment exposures to the various hedge fund styles are shown in the following table:

Style	Target	Minimum	Maximum
Market Neutral	5%	0%	10%
Credit	15%	5%	25%
Event Driven	20%	10%	30%
Equity Long/Short	25%	15%	35%
Global Macro	20%	10%	30%
Multi-Strategy	15%	10%	20%
Total	100%		

Non-US exposure will be embedded across the above listed strategies with the objective of building a globally diversified program. The embedded targeted beta with the global stock market is 0.3.

Consistent with the DCRB Rebalancing Policy, the targeted percentages and ranges established for each hedge fund strategy form the framework for allocating assets of Absolute Return portfolio. Within these funding restrictions, and in light of ever-changing market conditions, the CIO, in conjunction with the consultants, allocates funds to each investment strategy in a manner that, in their judgment, enhances the Fund's ability to achieve the investment objective of the Absolute Return portfolio over the long term. In the event a hedge fund strategy exceeds the maximum allocation percentage or is below the minimum allocation percentage, the CIO is authorized to rebalance assets in a manner consistent with this Policy in order to achieve the target allocation percentage for the respective hedge fund strategy.

3. **Investment Vehicles:** The vehicles for hedge fund investments are typically limited partnerships, but may also include other entities such as limited liability companies or offshore corporations. These investment vehicles may invest in any type of security throughout the capital structure.

4. **Industry/Geographic/Strategy Concentration:** DCRB shall endeavor to limit the potential for any one investment to negatively impact the long-term results of the Absolute Return Program by investing across a variety of industries, geographic locations and strategies.

5. **Investment Vehicle Concentration:** DCRB shall not comprise more than 20% of any one investment vehicle, and any one investment vehicle may not comprise more than 20% of the Absolute Return Program once it is fully invested. The optimum number of investment vehicles in the portfolio and the maximum exposure to any one investment vehicle varies with time and will be evaluated on an on-going basis. In addition, the weightings to individual funds and exposures may temporarily exceed the limits previously indicated to the extent that lock-up periods or other liquidity restrictions with respect to a hedge fund prevent an immediate reallocation.

6. **Liquidity:** Individual hedge fund investments have specified liquidity parameters defining lock-up periods and withdrawal frequency. Liquidity risk is managed by monitoring and maintaining a schedule of the liquidity of the individual hedge funds and aggregating it at the total Absolute Return Program level. While a preference exists for hedge funds offering regular monthly/quarterly redemption rights, consideration will be given to hedge funds with liquidity restrictions in exchange for lower fees or investment strategies that utilize less liquid securities and longer time horizons. Portfolio liquidity will be actively monitored with the expectation is that after the first year approximately 50% of the direct hedge fund portfolio could be liquidated within twelve months, and the remainder within three years. The expectation is that side pocket investments should not exceed 20% of the total Direct Hedge Fund Portfolio.

7. **Leverage:** Leverage may be utilized by the underlying hedge fund managers as part of their strategies but it will not be employed at the total portfolio level. Leverage

utilization will be monitored within each hedge fund to ensure appropriateness given the respective strategy.

8. **Fund Performance Evaluation:** The performance of individual hedge funds will be evaluated compared to their expected return premium over 3 month LIBOR (500 basis points) over trailing 5 year periods, net of all fees and expenses, as well as their respective peer universe over shorter time periods, as measured by a recognized hedge fund index provider (i.e., HFRI).

D. Monitoring

Through the monitoring process, the CIO and investment consultant(s) will extend the initial due diligence into a formal monthly, quarterly, semi-annual, and annual process which regularly seeks to determine whether the manager is meeting the Absolute Return Program's investment objectives and other requirements. In the broadest sense, the monitoring process is intended to determine whether the initial reasons for selecting the strategy and investment vehicle remain valid. The monitoring process should disclose whether there has been any material deviation from the investment philosophy and process; the personnel responsible for managing the investment vehicle are still in place; the organization continues to be stable; performance and risk meet expectations; and the investment vehicle manager adheres to its investment and other requirements. The underlying principle of the monitoring program is to determine whether all risks to which DCRB is exposed through the use of outside investment advisors have been identified, understood, and, to the extent possible, controlled. The monitoring process focuses on four areas:

1. Compliance with reporting and valuation requirements;
2. Continuity of investment philosophy and process;
3. Stability of personnel and organization; and
4. Performance and risk management.

The CIO and consultant(s) will aggregate investment vehicle data and perform analysis on the overall Absolute Return Program, paying careful attention to individual hedge fund allocations and strategy/sector concentrations to strive to achieve proper diversification across the Absolute Return Program. The CIO and consultant(s) also will conduct due diligence with the respective investment vehicle managers to understand the underlying drivers of risk and return. The CIO and consultant(s) shall conduct portfolio reviews and on-site due diligence as necessary. Additionally, the CIO and consultant(s) will address any fund amendments or other legal issues in a timely manner. The CIO and consultant(s) shall provide the DCRB Board with regular performance reports and advise the DCRB Board of other matters as appropriate.

DISTRICT OF COLUMBIA RETIREMENT BOARD
RECORD OF OFFICIAL BOARD ACTIONS

Board Motion Tally #3			Date: September 20, 2012		
To approve the Investment Policy Statement for the Absolute Return Program as presented by Cliffwater.					
Members	Aye	Nay/ Oppose	No Vote/ Abstain	No Vote/ Recuse	Absent
Blanchard, Lyle M.					√
Blum, Barbara Davis					√
Bress, Joseph M.	√				
Bulger, Diana K.	√				
Bunn, James E.	√				
Hensley, Deborah	√				
Marcus, Judith C.	√				
Ross, Darrick O.	√				
Smith, Edward C.	√				
Suter, George R.	√				
Tippett, Thomas N.	√				
Warren, Michael J.	√				