Section III: Treasurer-Managed Capital Asset Investment

Background and Overview

The Connecticut Retirement Plans and Trust Funds ("CRPTF") was established by the Treasurer of the State of Connecticut ("the Treasurer"), and approved by the Investment Advisory Council ("IAC"), in accordance with the provisions of subsection (c) of Section 3-13b of the Connecticut General Statutes. Invested assets of the following plans and trusts are pooled together:

1. State Employees' Retirement Fund,
2. Teachers' Retirement Fund,
3. Connecticut Municipal Employees' Retirement Fund,
4. Probate Judges and Employees Retirement Fund,
5. State Judge's Retirement Fund,
6. State's Attorneys' Retirement Fund,
7. Soldiers', Sailors' and Marines' Fund,
8. Arts Endowment Fund,
9. Agricultural College Fund,
10. Ida Eaton Cotton Fund,
11. Andrew C. Clark Fund,
12. School Fund,
13. Hopemead Fund, and
14. Police and Firemen Survivors' Benefit Fund.
15. Other Post-Employment Benefits Trust Fund

Pursuant to the Connecticut General Statutes, the Treasurer is the principal fiduciary of the CRPTF. Responsibilities in this regard are governed by fiduciary law and standards, and by the Constitution and laws of the State of Connecticut.

In carrying out these responsibilities, and as an elected Constitutional Officer of the State of Connecticut, the Treasurer is responsible for the investment and custody of all CRPTF assets and the selection of and contracting with all money managers, investment partners and other service providers.

The Treasurer may retain money managers, investment partners and other service providers to assist in the management of the assets held by the CRPTF and will exercise prudence and care in selecting, instructing and supervising such providers of investment and investment related services. The Treasurer may invest CRPTF assets directly into companies, including investment funds, limited partnerships, limited liability companies, REITs and conduct due diligence, select and monitor the management of such direct investment vehicles. Consistent with Section 3-13i of the Connecticut General Statutes, before the retention of any such money manager, investment partner or professional consultant, the Treasurer will present recommendations to the IAC for its consideration. After such presentation, unless waived by a vote of the IAC, the IAC will have up to 45 days to review and comment upon any proposed contract for investment advisory services prior to the execution of such a contract by the Treasurer. The Treasurer is responsible for negotiating the terms of the contract and subsequent amendments to said contract.

Asset Allocation

To provide a means for investing pension plans and other trust fund assets in a variety of investment asset classes, open end investment portfolios known as combined investment funds ("CIF") have been established. The CIFs are as follows and are classified as Liquid, Hybrid Liquid and Illiquid portfolios.

Liquid

1. Mutual Equity Fund (US Equity)
2. Developed Markets International Stock Fund (Developed Markets Equity)
3. Emerging Markets International Stock Fund (Emerging Markets Equity)
4. Core Fixed Income Fund (Core Bonds)
5. Inflation Linked Bond Fund (Global Inflation Linked Bonds)
6. High Yield Bond Fund (High Yield Bonds)
7. Emerging Market Debt Fund (Emerging Market Bonds)
8. Liquidity Fund (Cash and Short Term Investments)

Hybrid Liquid

9. Alternative Investment Fund (Hedge Funds, Private Credit and Real Assets)

Illiquid

10. Real Estate Fund (Real Estate Separate Accounts and Funds)
11. Private Investment Fund (Private Equity, Venture Capital)

The asset allocation to the CIF's for each of the CRPTF is established by the Treasurer, with approval of the IAC, based on (1) capital market theory, (2) financial and fiduciary requirements, and (3) liquidity needs. Benefit payments, trust distributions and plan expenses in excess of contributions are paid from the investment program.

A broad array of asset classes is considered for inclusion in a potential asset allocation structure. Each asset class has its own distinct characteristics, as well as expectations for long term return and risk behavior. Mathematical modeling is used to determine which mix of asset classes maximizes return at each level of risk. In addition to the asset allocation policy then in place, several alternative asset mixes are selected for further analysis. The liabilities or trust distribution needs are modeled in detail and projections are made based on the actuarial or spending assumptions underlying each of the retirement plans and trusts. The behavior of both the asset classes and the liabilities are tested under different economic scenarios using sophisticated simulation software. The outcomes of these tests are then examined to determine which asset mix offers a balanced risk/return tradeoff as measured by the impact on the liabilities or spending policy over multiple time horizons.

For purposes of this report, the capital assets discussed by the Pension Sustainability Commission ("Commission") could be considered for inclusion in the Real Estate Fund ("REF") and/or the Real Assets portion of the Alternative Investment Fund ("AIF"), subject to the guidelines established in the Investment Policy Statement ("IPS"). Further details of these considerations follows.

Real Estate Assets

Capital assets identified for transfer into the pension plan(s) that would otherwise qualify as real estate assets could be allocated to the REF depending on the capacity within the asset allocation policy for the given real estate strategy.

The REF is the CIF through which the CRPTF makes investments in the real estate asset class. The investments may consist of a number of different investment strategies and investment vehicles, including externally managed commingled funds, separate accounts and/or publicly traded real estate securities. All investments in real estate assets are expected to adhere to the standards of fiduciary obligation to the beneficiaries of the CRPTF, and will be considered in the context of the relevant risk/reward factors of this asset class and consistent with the statutory requirements for consideration of investments by the Treasurer in accordance with Section 3-13d (a) of the Connecticut General Statutes.

Investment selection entails a comprehensive, thorough process of due diligence and investigation of the critical factors on which an investment decision is to be based, including quantitative and qualitative analysis of the investment partner, its professionals and their ability to successfully implement their stated investment strategy within the context of current and prospective market environments.

In general and at time of investment, the following REF investment restrictions/limitations would apply to any State assets that are classified as real estate:

- The Investment Partners will follow the contract process for the State of Connecticut Retirement Plans & Trust Funds Responsible Contractor Policy – Real Estate Fund.
- Open-ended Real Estate Investments will be structured to include clearly defined redemption provisions. For closed-end investments, exit or sale provisions will be clearly defined.
- Investment Partners will value all portfolio investments at least annually by qualified third-party appraisal firms or internal processes that are deemed to be institutional quality.
- Independent third party valuations will be obtained, at a minimum, every three years (subsequent to completion of construction) or on an as needed basis.
- No more than 10 percent of the target REF will be allocated to any one individual investment vehicle in which the CRPTF does not have the ability to exit the investment or terminate the manager. Each separate account will not exceed 20% of the target REF.
- No single investment partner will manage more than 25 percent of the market value of the REF allocation.
- General Partners will be required to ensure that all REF investments adhere to all limitations imposed by Connecticut and/or federal law.

Infrastructure Assets

Capital assets identified for transfer into the pension plan(s) that would otherwise qualify as infrastructure assets could be allocated to the Real Assets sub-target allocation within the AIF depending on the capacity within the asset allocation for the real assets strategy.

In general and at time of investment, the following REF investment restrictions/limitations would apply to any State assets that are classified as infrastructure:

- Investment managers will adhere to the investment strategy, diversification limits and administrative guidelines described in their private placement memorandum and related contracts;
- Investment managers will be required to ensure that all AIF investments adhere to all limitations imposed by Connecticut General Statutes and/or federal law;
- No more than 20% of the AIF’s policy target allocation should be invested in any one investment vehicle