

## **Statement of Policy for the Risk Management Program**

### **I. Purpose**

The Illinois State Board of Investment (the “Board”) has adopted this Statement of Policy for the Risk Management Program (“Risk Policy”) for the purpose of ensuring that the Board’s Risk Management Program (the “Program”) is effectively managing the risk levels of the Board’s total portfolio of assets. Currently, the Board has fiduciary responsibility for managing and investing the assets of the total portfolio of retirement assets belonging to the State Employees’ Retirement System of Illinois, the Judges’ Retirement System of Illinois, the General Assembly Retirement System of Illinois, and the Illinois Power Agency Trust collectively (the “Fund”).

The intent of this Risk Policy is to manage investment risk in order to meet or exceed the actuarially assumed rate of return, as adopted by the Board. The objective of this Risk Policy is to ensure that the investment risk taken in order to achieve the aforementioned return is both prudent and appropriately managed.

### **II. Strategic Objectives**

The Program shall be organized to achieve the following objectives:

- Provide a fully integrated process for management of the Fund’s investment risk;
- Advise the Board and Staff on risk issues and develop risk reports, policies, and guidelines that implement risk tolerances as defined by the Board, Staff and Consultants;
- Support all levels of the organization in understanding and analyzing investment risks across the Fund;
- Ensure the independence and integrity of risk reporting; and
- Prioritize risks taken and evaluate the Fund’s returns in relation to its associated risks to determine if risks taken are appropriately rewarded.

### **III. Scope**

The Program shall manage only the investment risk of the Fund and shall not manage other types of risk within the organization.

### **IV. Risk Benchmark**

The performance and progress of the Program shall be evaluated based on: external risk consultants, assessment of the Program by the Board, Staff and Consultants, and the performance of comparable pension fund risk management programs.

### **V. Risk Budget**

- a. The Program shall implement an annual risk budget that consists of a dynamic risk mitigation strategy that uses a balanced approach to risk mitigation. The below are factors that will be used to create this balanced approach:

- i. Value at risk (VaR), which describes the expected loss at a certain point of market severity (VaR will be measured in currency units or as a % of market value);
- ii. Conditional value at risk (CVaR), which states average losses when a specified negative event actually occurs; and
- iii. Use of both pro-cyclical and anti-cyclical risk budgets, combined in order to balance as many return-seeking assets as possible with as many safe assets as necessary:
  1. Pro-cyclical is defined as a budget that increases the risk exposure of a portfolio in rising markets and decreases the risk exposure of a portfolio in declining markets; and
  2. Anti-cyclical is defined as a budget that decreases the risk exposure of a portfolio in rising markets and increases the risk exposure of a portfolio in declining markets.

## **VI. Oversight and Compliance**

- a. The Board's Manager for Risk and Analytics shall oversee the Program and ensure compliance with this Policy.
- b. The Board's Manager for Risk and Analytics is responsible for the following:
  - Driving the selection, maintenance, and enhancement of risk management tools used by the Program;
  - Providing periodic risk reports to the Board and Staff, as outlined in this Policy;
  - Continuously monitoring investment risk and advising the Board and Staff of risk issues as they develop; and
  - Working with Staff to monitor the trade-off between risk and return on both an asset-class and total Fund basis and recommending adjustments accordingly.

## **VII. Risk Reporting**

All risk reporting will prioritize risk based on the likelihood of realization of risk and its impact on the Fund, taking into account the risk intentionally incurred by the Fund in order to achieve the Board's desired return.

### Daily Risk Monitoring

On a daily basis, the Program shall:

- Monitor investment guideline compliance by the Board's investment advisers ("Advisers");
- Report performance, net asset values and allocations to the portfolio managers; and
- Record and monitor capital events.

### Quarterly Risk Reporting

On a quarterly basis, the Program shall provide Staff with the following analytic reports on the Fund:

- *Forecasted risk*, including: total risk, active risk (i.e., tracking error), value at risk, and factor exposures at the Fund, asset class, strategy, investment manager and security levels;
  - Factor exposures may include: macroeconomic, environmental, social, and governance factors.
- *Liquidity risk* based on asset allocations to illiquid types of investment or illiquidity generated by certain Advisers and partnerships (i.e., market liquidity), and the funded status of the Fund (i.e., funding liquidity);
- *Leverage risk* based on notional leverage by asset class, including unfunded capital commitments;
- *Currency risk* based on actual Fund currency exposures versus benchmark currency exposures;
- *Counterparty risk* based on counterparty exposure to issuers, Advisers, the Board's Custodian, prime brokers and brokers;
- *Credit risk* based on counterparty credit ratings, credit default swap spreads, stock prices, and peer comparisons;
- *Concentration risk* based on asset class allocations, industries, countries, and issuers;
- *Underperformance risk* in the near-term and long-term relative to the actuarially assumed rate of return adopted by the Board; and
- Back-test analysis showing the proximity of forecasted risk to realized risk and the directional correctness of forecasted risk to realized risk.

#### Quarterly Valuations

On a quarterly basis, the Program shall:

- Roll forward and reconcile the net asset values for all alternative asset classes; and
- Reconcile cash flows between the Board's alternative asset class managers, its internal accounting system, and its Custodian.

#### Annual Valuations

- On an annual basis, the Program shall reconcile the net asset drift for all alternative asset classes.

#### Ad Hoc Risk Reporting

On an ad hoc basis, the Program shall provide the following reports to Staff:

- Stress testing based on potential or historical, geopolitical or economic events; and
- Scenario analysis based on potential changes to asset allocations or other changes to investment strategy.

Annual Risk Review of Advisers On an annual basis, Advisers shall electronically submit the below reporting, to be analyzed by Staff in an effort to consider trends over time:

- Adviser's total assets under management for the firm and for the product pertaining to the Board's account under management with Adviser (the "Account");
- Adviser's change in management and/or ownership, if any;
- Adviser's change in third-party service providers (i.e., audit/tax, legal, bank and/or custodian/administrator, IT service provider or others);
- Adviser's change in IT systems, backup/disaster recovery plan, and/or document retention policy;
- Any pending, threatened or recently settled (within the last twelve months) litigation in which the firm, its individual members, affiliated entities or portfolio companies are named as parties to the litigation, including a summary of the litigation and claims made;
- Any current or anticipated actions, inquiries, or investigations by any federal, state, or local government agencies or regulatory bodies conducted on the firm, its affiliates or its individual members;
- Existing and/or any changes to Adviser's Errors and Omissions and Directors and Officers Liability insurance coverage amount and period of coverage;
- Total clients gained and lost, as well as the assets gained and lost, for the product pertaining to the Account;
- Disclosure of changes, if any, to the investment philosophy and investment process (e.g., trade/foreign exchange execution) for the product pertaining to the Account;
- Annual turnover for the product pertaining to the Account;
- Disclosure of change or anticipated change, if any, to firm personnel for the product pertaining to the Account;
- Organizational chart of the Account's asset management group;
- Summary of violations, if any, of Adviser's Code of Ethics, including disclosure of any amendments to the Code of Ethics and an updated version, if applicable;
- Adviser's internal control report (i.e., SSAE16 Statements for Standards on Attestation Engagement, CPER Compliance Examination Report, or similar report which provides verification of Adviser's operational controls), including disclosure of any changes to controls from the prior year;
- Adviser's disaster recovery plan, including disclosure of test frequency and results;
- Summary of Adviser's counterparty review process and discussion of results, including current credit ratings of counterparties engaged in the Account. For counterparties rated below investment grade, the Adviser shall provide calculation of maximum loss due to credit risk, based on the fair value of the derivative as of the end of the reporting period, if the counterparty failed to perform according to terms of the contract, without respect to any collateral or other security, or netting arrangement [only applicable to Advisers trading OTC derivatives and forward currency contracts];
- Adviser's back office procedures relevant to the Account;

- Certification that more favorable fees are not in effect between Adviser and any other client with the same investment management strategy as the Account and disclosure (and if requested, documentation) of the fee schedules for the ten (10) clients with the same investment management strategy and closest in asset value to the Account (with the closest five (5) clients with higher and lower asset values being included, to the extent applicable);
- Adviser's most recent ADV;
- Statutory or regulatory body that supervises the operations of Adviser;
- Any material disclosures that may impact the Account;
- A copy of Adviser's proxy voting policy [only applicable to commingled fund Advisers]; and
- A signed Certification Statement, acknowledging Adviser's compliance with its investment guidelines, reimbursement to the Board as a result of trading errors, compliance with Adviser's Code of Ethics and the CFA Institute's Code of Ethics, compliance with the CFA Institute's Soft Dollar Standards, noting and explaining any exceptions to compliance; and if designated as a Qualified Independent Representative (QIR), compliance with business conduct rules and applicable representations.

#### Annual Review of the Board's Private Equity and Real Estate Portfolios

On an annual basis, each of the Board's private equity partnerships ("Partnership") shall provide the following:

- Summary of any changes made to Partnership's valuation policy and, if applicable, a copy of Partnership's revised valuation policy;
- Description the Partnership's use and frequency of use of third party valuation consultants;
- Partnership's formal valuation process, and any significant valuation issues addressed in the past year as a part of that process;
- Partnership's use of a formal valuation committee and, if applicable, any membership changes to that committee;
- Partnership's change in management and/or ownership, if any;
- Partnership's most recent SEC examination and, if applicable, any findings, deficiencies, or violations identified by that examination;
- Any compliance related issues with any limited partner side letter or the limited partnership agreement;
- Partnership's change in strategic relationships or partnerships with third party firms, if any;
- Partnership's change to their investment committee, if any;
- Partnership's plans for a successor fund or a fund with a different investment strategy than the fund in which the Board invests;

- Any conflicts brought to the Partnership's advisory board within the last 12 months and, if applicable, a summary of the conflicts and resolutions;
- A copy of the Partnership's responsible contractor policy, if applicable;
- Statutory or regulatory body that supervises the operations of the Partnership;
- Any material disclosures that may impact the Board's investment;
- Existing and/or any changes to Partnership's Errors and Omissions and Directors and Officers Liability insurance coverage amount and period of coverage;
- Partnership's existing and/or change in third-party service providers (i.e., audit/tax, legal, bank and/or custodian/administrator, IT service provider or others);
- Partnership's back office procedures relevant to the Board's investment;
- Partnership's existing and/or change in IT systems, backup/disaster recovery plan, and/or document retention policy;
- Partnership's disaster recovery plan, including disclosure of test frequency and results;
- Partnership's most recent ADV;
- Any pending, threatened or recently settled (within the last twelve months) litigation in which the firm, its individual members, affiliated entities or portfolio companies are named as parties to the litigation, including a summary of the litigation and claims made; and
- Any current or anticipated actions, inquiries, or investigations by any federal, state, or local government agencies or regulatory bodies conducted on the firm, its affiliates or its individual members.

**VIII. Securities Lending**

The Staff will manage the risk of this program in accordance with the Board's Securities Lending Policy.

**Adopted:** June 19, 2015