Investment Policy Statement

City of Erie
Aggregate Pension Funds

Adopted: February 2001
Revised: May 2003
Revised: November 2007
Revised: December 2007
Revised: November 2010
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Revised: August 2012
Revised: March 2013
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I. INTRODUCTION

Purpose of this Policy Statement

This policy statement outlines the goals and investment objectives for the Pension Funds overseen by the City of Erie Aggregate Pension Board (these Funds referred to herein as the "Funds"). Since this document is intended to provide guidelines for managing the Funds, this document outlines certain specific investment policies that will govern how the Funds' investment goals are expected to be achieved.

This statement:

- Describes an appropriate risk posture for the investment of the Funds' assets,

- Establishes investment guidelines regarding the selection of investment managers, permissible securities and diversification of assets,

- Specifies the criteria for evaluating the performance of the investment managers and of the Funds as a whole,

- Defines the responsibilities of the Pension Board and other parties responsible for the management of the Funds.

The Pension Board believes that the investment policies described in this statement should be dynamic. These policies should reflect the Funds' actuarial condition, the financial status of the City of Erie, and the Pension Board's duties regarding the investment of assets. These policies will be reviewed and revised periodically to ensure they adequately reflect changes related to the Funds, the City of Erie, and the capital markets.

Investment Objective

The funding obligations of the Funds are long-term in nature; consequently the investment of the Funds' assets shall have a long-term focus. The Funds' assets shall be invested in accordance with sound investment practices that emphasize long-term investment fundamentals. The investment objectives for the Funds' are:

- To achieve a positive rate of return for the Funds over the long-term that significantly contributes to meeting the Funds' obligations, including actuarial interest and benefit payment obligations;
- To provide for asset growth at a rate in excess of the rate of inflation;
- To diversify the Funds' assets in order to reduce the risk of wide swings in market value from year-to-year, or of incurring large losses;
- To achieve investment results over the long-term that compare favorably with those of other professionally managed portfolios, public pension plans and of appropriate market indexes.

It is expected that these objectives can be obtained through a well-diversified portfolio structure in a manner consistent with this investment policy.

This investment policy is intended to be a summary of an investment philosophy that provides guidance for the Pension Board and other parties interested in the management of the Funds. The guidance and limitations set forth in this statement are intended to provide the Pension Board with a clear understanding of the investment policies and objectives of the Funds. It is the intent of this investment policy statement to provide a meaningful framework for the investment objectives of the Funds and that these policies will not be overly restrictive given changing economic, business, and capital market conditions. It is understood that there can be no guarantees about the attainment of the goals or investment objectives outlined here.

II. THE CITY OF ERIE FUNDS

City of Erie Aggregate Pension Board
626 State Street
Erie, PA 16501
Tel. (814) 870-1339

<u>Primary Contact</u>
Ms. Teresa Stankiewicz, Controller
tstankiewicz@erie.pa.us

<u>Total Assets</u>
$222,571,679.00
As of December 31, 2013 (Fiscal year end)

The City of Erie sponsors these defined benefit pension plans in order to provide participants with a source of retirement income along with that received from participants' personal savings. The Funds are currently comprised of three pension funds:

<u>Individual Pension Plans</u>

1. City of Erie Officers' and Employees' Pension Plan

2. City of Erie Firefighters' Pension Plan

3. City of Erie Police Pension Plan

<u>Cash Flows and Liquidity Needs</u>

The cost of the Funds is funded by contributions from the City, the State of Pennsylvania, participant contributions, and investment earnings. Fund benefits can be paid as an annuity or, under certain provisions, as a lump-sum payment.

The funding policy for the Funds is for the City, the State of Pennsylvania and participants to contribute an amount sufficient to cover both (1) the on-going normal cost of the Funds and (2) to finance the unfunded accrued liability over an actuarially determined time period. The financial objective of such a policy is to maintain a stable contribution rate as a percent of payroll from year-to-year and to meet the Funds' benefit payment obligations over the long-term.

Disbursements from the Funds are for the payment of Funds' benefits and expenses. Projected disbursements from the Funds are expected to grow at a moderate pace in line with inflation.

Regulatory Environment

The Funds operate in accordance with City Ordinances and State of Pennsylvania Public Act #205 of 1945, as amended ("Public Act #205").

III. RESPONSIBILITIES

Aggregate Pension Board

The City of Erie Aggregate Pension Board (the "Pension Board") is responsible for establishing investment policy for the Funds and to implement approved policies and guidelines.

It is expected that the objectives and policies described here will be used as the criteria for selecting and evaluating the appropriate investment managers for the management of the Funds' assets. Specifically, the responsibilities of the Pension Board include:

- Establishing a long-term strategic investment plan for the Funds. This includes evaluating their risk tolerance and establishing a long-term asset allocation policy consistent with the long-term investment objectives, financial needs and circumstances of the Funds;

- Recommending an appropriate investment manager structure and the selection or termination of investment managers/funds;

- To monitor and evaluate the performance of the Funds' assets as a whole and of each investment manager;

- The selection or termination of administrators, consultants, and custodian for the Funds' assets;

- Such other duties as may be described in this policy or as required by applicable laws and regulations.

Investment Consultant

The Pension Board may retain an investment consultant to provide advice on the management of the Funds. The investment consultant shall acknowledge that it is being retained by the Pension Board as an expert with respect to investment consulting services as summarized in this investment policy and as contracted. The investment consultant will provide the services contracted for in order to assist the Pension Board in making prudent investment judgments. In performing services as summarized below, the investment consultant shall act solely in the best interest of the Funds and shall have a reasonable basis for any advice rendered. However, final decision making authority and responsibility resides with the Pension Board.

The Investment Consultant retained by the Pension Board shall have the following responsibilities for the Funds:

- To assist the Pension Board in strategic investment planning for the Funds. This includes providing assistance in developing an investment policy, asset allocation strategy, and investment manager structure;

- To provide to the Pension Board quarterly performance measurement reports for each of the investment managers and to assist the Pension Board in interpreting the results;

- To act as a liaison between investment managers and the Funds, and thereby facilitate the communication of important information in the management of the Funds;

- Such other duties as may be mutually agreed to.

IV. RESPONSIBILITIES OF INVESTMENT MANAGERS

It is the intention of the Pension Board to utilize separately managed accounts to implement the investment strategy of the Funds, where practical. Mutual funds or other commingled investment vehicles may also be used from time-to-time to implement the investment strategy of the Funds. For mutual and other commingled funds, the prospectus or Trust documents of the fund(s) will govern the investment policies of the fund investments. Investment managers, however, shall be guided by the general principles and constraints outlined in this investment policy. The following guidelines apply to the separately managed accounts:

<u>Fiduciary Responsibilities</u>

Each investment manager is expected to manage the Funds' assets in a manner consistent with the investment objectives, guidelines, and constraints outlined in this statement and in accordance with applicable laws, including Public Act #205. This would include discharging responsibilities with respect to the Funds consistent with "Prudent Expert" standards, and all other fiduciary responsibility provisions and regulations. The Funds' assets will be managed by experienced investment management firms.

Each investment manager shall:

- At all times be registered as an investment adviser under the Investment Advisers Act of 1940 (where applicable); and

- Acknowledge in writing that they are a fiduciary with respect to the assets they manage.

<u>Security Selection/Asset Allocation</u>

Except as noted below, each investment manager shall have the discretion to determine their portfolio's individual security selections.

Each investment manager has been delegated responsibility for establishing and maintaining the asset allocation strategy for their individual portfolio. It is expected, however, that each investment manager will utilize a stable asset allocation strategy and not engage in tactical or market-timing asset allocation decisions. The performance of each investment manager is measured versus a fully invested market index, or combination of market indexes, representative of the investment manager's investment style, asset allocation, and risk level.

<u>Proxy Voting</u>

Each investment manager is responsible and empowered to exercise all rights, including voting rights, as are acquired through the purchase of securities, where practical. Each investment manager shall vote proxies according to their established Proxy Voting Guidelines. A copy of those guidelines, and/or summary of proxy votes shall be provided to the Pension Board upon request.

V. RISK TOLERANCE

Investment theory and historical capital market return data suggests that, over long periods of time, there is a relationship between the level of risk assumed and the level of return that can be expected in an investment program. In general, higher risk (i.e. volatility of return) is associated with higher return.

Given this relationship between risk and return, a fundamental step in determining the investment policy for the Funds is the determination of an appropriate risk tolerance. The Pension Board examined two important factors that affect their risk tolerance:

- **Financial Ability** to accept risk within the investment program and
- **Willingness** to accept return volatility.

Positive factors that contribute to a higher risk tolerance are:

(1) The long-term nature of the funding obligations of the Funds; and

(2) The financial strength of the City.

Offsetting these factors are:

(1) The Funds are a significant source of retirement income to most Funds participants;

(2) The requirement to contribute to the Funds to maintain the funding status of the Funds in the event of any large losses and such contributions may coincide with poor financial results for the City; and

(3) The desire by the Pension Board to avoid large fluctuations in the market value of the Funds from year-to-year that may arise from holding concentrated positions.

VI. ASSET ALLOCATION STRATEGY

In line with the return objectives and risk parameters of the Funds, the mix of assets should be generally maintained as follows (percentages are of the market value of the Funds):

Asset Class	Min	Target	Max
Domestic Large/Medium Capitalization Stocks	30%	35%	40%
Domestic Small/Medium Capitalization Stocks	0%	5%	10%
International Equity	5%	15%	18%
Real Estate Securities	0%	5%	10%
Total Equity	45%	60%	65%
Investment Grade Fixed Income	25%	30%	50%
Non Investment Grade Fixed Income	0%	5%	7%
Cash and Cash Equivalents	0%	5%	20%
Total Fixed Income	35%	40%	55%

Deviations from this asset mix guideline may be authorized in writing by the Pension Board, which may determine if the aggregate deviation does not constitute a material departure from the spirit of the target allocation.

The maximum percentage designated for the "Cash and Cash Equivalents" category is intended to apply after the initial start-up of any one portfolio in the Funds. The Pension Board recognizes that this initial start-up period to become fully invested could be as long as three months after the initiation of a portfolio.

The Controller, in concert with the Investment Committee and on the advice of Investment Consultant, can temporarily invest up to 5% of each Fund's assets in (or remove assets from) various Vanguard index funds or ETFs without prior approval of the Board. Any transactions implemented under this authority must be reported, justified and approved by the Board at a subsequent meeting.

Prior to adding a new asset class to any of the Pension Funds, the Aggregate Pension Board will first make motion to approve consideration of adding the new asset class to afford sufficient time for comprehensive analysis by Investment Consultant and thorough evaluation by Investment Committee before a final decision is made regarding the addition of said new asset class.

Rebalancing Procedures

The allocation to each asset class and to investment styles within assets classes is expected to remain stable over most market cycles.

Since capital appreciation (depreciation) and trading activity in each individually managed portfolio can result in a deviation from the overall asset allocation, the aggregate asset allocation will be monitored and the Pension Board may review the asset allocation and manager structure at least annually.

Should an allowable range for the asset classes be violated, the Pension Board must meet or conference to decide whether to rebalance the existing assets to the target asset mix. In addition, the Pension Board shall review the actual asset allocation at each meeting in order to ensure conformity with the adopted strategic allocation.

To achieve the rebalancing of the Funds, the Pension Board may re-direct contributions and disbursements from individual investment managers as appropriate, in addition to shifting assets from one investment manager to another. The Pension Board shall coordinate all rebalancing actions with the Investment Consultant and the Investment Managers.

VII. PERFORMANCE OBJECTIVES

In consideration of the long-term investment objectives of the Funds' assets and the Pension Board's risk tolerance, the Pension Board has adopted an overall investment objective of long-term growth and current income. This investment objective is a balanced approach that is expected to earn long- term total returns comprised of capital appreciation and current income.

The Pension Board will monitor the performance of the Funds on a quarterly basis. The Pension Board will evaluate each investment manager's contribution toward meeting the investment objectives outlined below over a three- to five-year time period and a full market cycle, unless otherwise noted.

Style Index: It is desired that the Funds earn returns higher than the "market", as represented by a benchmark index or mix of indexes reflective of the Funds' return objectives and risk tolerance. This benchmark or "style index" is to be constructed as follows:

- 35% Standard & Poor's 500 Stock Index
- 5% Russell 2000 Stock Index
- 15% Morgan Stanley Capital International Europe, Australasia, and Far East (MSCI EAFE) International Stock Index
- 5% Wilshire Real Estate Securities Index
- 25% Merrill Lynch Corporate Government and Mortgage Index. (Formerly the Merrill Lynch U.S. Domestic Master Bond Index)
- 10% Merrill Lynch Corporate & Government Bond 1- 5 Years Index.
- 5% 90 Day U.S. T-Bill

The Funds are expected to exceed the average annual return of this benchmark on a risk-adjusted basis over a three- to five- year rolling time period and a full market cycle.

<u>Secondary Performance Targets</u>:

1. The real return goal (return after adjusting for inflation) for the Funds' assets is 5%. Inflation shall be measured by the U.S. All Urban Consumers Price Index ("CPI").

2. A dollar-weighted average return goal of 8%, regardless of market conditions.

3. The Funds are expected to outpace the style index return and real return target, each measured on a compound average annual return basis after the deduction of investment management fees and annualized over a three- to five-year rolling time period and a full market cycle.

4. Performance will be compared to a peer group universe comprised of other public pension plans.

VIII. INVESTMENT STRATEGY

Selection Criteria for Investment Managers

Investment managers retained by the Pension Board shall be chosen using the following criteria:

- Past performance, considered relative to other investments having similar investment objectives. Consideration shall be given to both consistency of performance and the level of risk taken to achieve results;

- The investment style and discipline of the investment manager;

- How well the manager's investment style or approach complements other assets in the Funds;

- Ability and willingness to service this account on a customized basis and documented in this investment policy or the manager's agreement with the City;

- Restrictions, if any, on the frequency with which investors may transfer assets into or out of any fund or separately managed portfolio will be evaluated;

- Type and appropriateness of reporting and investor communication materials;

- Level of experience, personnel turnover, financial resources,and staffing levels of the investment management firm or fund;

- All mutual funds shall be registered Investment Companies as defined under the Investment Company Act of 1940. The Investment Companies need not be classified as "diversified" Investment Companies (as defined in the Investment Company Act of 1940);

- An assessment of the likelihood of future investment success, relative to other opportunities.

The Funds will utilize a multi-manager structure of complementary investment styles and asset classes to invest the Funds' assets.

Should additional contributions and/or market value growth permit, the Pension Board may retain additional investment managers to invest the assets of the Funds. Additional managers would be expected to diversify the Funds by investment style, asset class, and management structure and thereby enhance the probability of the Funds achieving its long-term investment objectives.

IX. INVESTMENT GUIDELINES

Commingled Fund Investments[1]

The investment guidelines for any commingled or mutual funds and limited partnerships are detailed in the prospectus or Declaration of Trust for the individual funds. The Pension Board has the responsibility to review these guidelines to ensure they are generally consistent with this investment policy. Where there are differences between the investment guidelines of the fund and this investment policy, the Declaration of Trust (or prospectus) shall govern.

Separately Managed Accounts

Investment activity must be consistent within the requirements of this policy, the City's management agreement with the investment manager, and applicable laws, including Public Act #205. Where there are differences between the investment guidelines included in the investment manager's investment management agreement and this investment policy, the investment guidelines included in the investment management agreement shall govern.

In addition, the following guidelines will apply:

A. Asset Allocation

Each investment manager has been delegated responsibility for establishing and maintaining the asset allocation strategy for their individual portfolio.

Unless otherwise noted below, under normal market conditions, each investment manager is expected to be invested primarily in equities and/or fixed income securities consistent with their investment style and their investment management agreement with the Pension Board. Except for the initial three months after being retained by the Pension Board, or as noted below, each investment manager shall not invest more than 20% of the market value of their portfolio in cash or cash equivalents. During the initial three months of the account relationship with the Funds, the investment manager may hold cash and cash equivalents in larger proportions in order to invest the portfolio on an orderly basis.

1. Commingled funds are pooled investment vehicles where investors own shares of the fund, but do not own the underlying investments of the fund. Commingled funds such as mutual funds and limited partnerships are sold to investors by prospectus or trust document only. These documents are the controlling investment guidelines of the fund and the investment advisor(s) to the fund have a fiduciary and legal obligation to abide by the provisions of the prospectus (or trust document), but do not have a fiduciary obligation to the Plan. Therefore, should the Plan invest in a pooled investment vehicle, these investment guidelines are not controlling over the fund investment and there is the possibility that fund investments may engage in transactions that are otherwise prohibited by this investment policy. For example, investing in other asset classes that would not otherwise be permitted for an investment manager, utilizing futures and options strategies or cash holdings at higher levels than what is permitted in this policy.

B. Permitted Securities

Domestic Securities
The securities purchased shall be registered with the Securities and Exchange Commission, and traded on a recognized U.S. stock exchange or over-the-counter-market.

Equity securities include: common stocks, real estate securities (defined below), and securities convertible into common stock of U.S.-based companies.

Convertible Securities
Securities that are convertible into the common stock of U.S. based companies. This would include convertible bonds, convertible preferred stock, and mandatory convertible securities (e.g. PERCs, CHIPs, ELKs). All convertible securities purchased must be U.S. dollar denominated securities. Individual convertible securities should be rated "B" (or its equivalent) or higher at the time of purchase by a nationally recognized statistical rating agency. For the purposes of asset allocation, convertible securities shall be considered equities.

Real Estate Securities
Equity REITs, mortgage REITs, CMO or mortgage-related securities REITs, Health Care REITs, and equities of real estate operating companies. Equity REITs are those securities that meet the National Association of Real Estate Investment Trusts' (NAREIT) asset mix definition of an equity REIT (currently, equity REITs are those where 75% of assets are equity financed properties). REITs may be perpetual life REITs or finite life REITs.

Fixed income securities
Domestic fixed and variable rate bonds and notes issued by the U.S. Government and its Agencies, U.S. corporations, Yankee bonds and notes (bonds or notes issued by non-U.S.-based corporations and governments but traded in the U.S.), securitized mortgages (e.g. GNMA's, FNMA's, FHLMC's), collateralized mortgage obligations, asset-backed securities, taxable municipal bonds, and preferred stock.

International Securities
Allowable international securities are: sponsored and unsponsored American Depositary Receipts (ADR's) or American Depositary Shares (ADS's) or other depositary securities of non-U.S. based companies traded in the U.S. and closed-end country funds. Equities of foreign domiciled companies that are traded in the U.S. may also be purchased so long as the securities are registered (or filed) with the Securities and Exchange Commission and traded on a recognized national exchange or over-the-counter market.

C. Diversification Requirements

To minimize the risk of large losses, each investment manager shall maintain adequate diversification in their portfolio. Subject to the constraints outlined in this investment policy, each investment manager shall have the discretion to determine their portfolio's individual security selections.

Large/Medium Capitalization U.S. Stock Portfolio(s)

- Investments in any one individual equity security should not exceed 5% of the market value of the overall equity exposure of the relevant fund;

- Holdings of any single issue in each investment manager’s portfolio shall not exceed more than 5% of the market value of the total outstanding common stock of any one company[2];

- The maximum allocation to any single economic sector in a portfolio shall not exceed the greater of 15% of the market value of the investment manager’s portfolio or 150% of the economic sector’s weighting in the S&P 500 Stock Index, or the investment manager’s equity policy index, if different. Economic sector definitions shall be according to the investment manager’s own classifications, which should be provided to the Pension Board upon request;

- Equities are limited to large and medium capitalization stocks. The minimum market capitalization at the time of purchase should be greater than $1 billion;

- From time-to-time, the investment manager may invest in U.S. dollar denominated equities of non-US companies that otherwise conform to the provisions of this investment policy.

Small/Medium Capitalization U.S. Stock Portfolio(s)

- Investments in any one individual equity security should not exceed 5% of the market value of the overall equity exposure of the relevant fund;

- Holdings of any single issue in each investment manager’s portfolio shall not exceed more than 5% of the market value of the total outstanding common stock of any one company[2];

- There are no constraints on the economic sector allocations of the portfolio. The investment manager may concentrate portfolio holdings in a limited number of economic sectors.

- Equities are limited to small and medium capitalization stocks.
  The market capitalization of any one equity security shall be between $100 million and $10 billion at the time of purchase;

- From time-to-time, the investment manager may invest in U.S. dollar denominated equities of non-US companies that otherwise conform to the provisions of this investment policy.

International Stock Portfolio(s)

- Investments in any one individual equity security should not exceed 5% of the market value of the overall equity exposure of the relevant fund;

- Holdings of any single issue in this portfolio should not exceed more than 5% of the total outstanding common stock of any one company[2];

- The maximum allocation to any single economic sector in a portfolio shall not exceed the greater of 15%of the market value of the investment manager's portfolio or 150% of the economic sector's weighting in the MSCI EAFE Index, or investment manager's primary equity policy index. Economic sector definitions shall be according to the investment manager's own classifications, which should be provided to the Pension Board upon request;

- Equities are limited to large and medium capitalization stocks. The minimum market capitalization at the time of purchase should be greater than $500 million.

- Thornburg Investment Managers International Equity Portfolio Only. The maximum allocation to any single economic sector in a portfolio shall not exceed the greater of 25% of the market value of the investment manager's portfolio or 150% of the economic sector's weighting in the MSCI EAFE Index, or investment manager's primary equity policy index. Economic sector definitions shall be according to the investment manager's own classifications, which should be provided to the Pension Board upon request;

Real Estate Securities Portfolio

- To provide for diversification in the portfolio, investments in any one security should not exceed approximately 8% of the market value of the investment manager's portfolio;

- Holdings of any single issue in this portfolio should not exceed more than 5% of the total outstanding common stock of any one company;

- Holdings shall be diversified by property type, geographic area, and management structure;

- Many REITs may invest in multiple property types. Therefore, diversification constraints described here may not be feasible. Nevertheless, the Pension Board desires that the investment manager keep in mind when selecting REITs for investment, the investment manager shall not concentrate an unreasonable amount of the portfolio in a particular property type (e.g. office buildings, shopping centers, warehouses);

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2. It is recognized, however, that an investment manager's holdings of a single issue in all portfolios firmwide may exceed this limit. This constraint applies only to the Plan's holdings.

- The investment manager should broadly diversify REIT holdings so that the portfolio has exposure to property holdings in a broad geographic area. Most REIT holdings in the portfolio should be U.S.-based, however, it is understood that some REITs may be headquartered outside the US and/or invest in properties located outside the US. It is not expected, however, that non-US based REITs or properties will comprise more than 25% of the market value of the portfolio;

- There is no constraint on the allocation to perpetual REITs or finite-life REITs. The investment manager should diversify the portfolio to include REITs managed by different management firms so that no more than 10% of the portfolio is concentrated with a single management firm.

Fixed Income Portfolio

- Fixed income securities (except for those listed below) shall be rated investment grade (i.e. "BBB-"[3] or its equivalent or higher) at the time of purchase by a nationally recognized statistical rating agency. The minimum dollar- weighted average credit quality rating of the fixed income portfolio shall be "A-". Asset backed securities, mortgage backed securities, and CMOs shall be rated "AAA" (or its equivalent) at the time of purchase by a nationally recognized statistical rating agency;

- Fixed income securities of a single issuer or issue, with the exception of U.S. Government and Agency securities, are limited to no more than 8% of the market value of the fixed income portfolio;

  No more than 30% of the market value of an investment manager's portfolio may be invested in a single sector of the corporate fixed income market. Sector definitions shall be according to the investment manager's own classifications, which should be provided to the Pension Board upon request. NIS Preferred Portfolio will be exempt from the 30% due to large issuance of preferred stock by financial companies (85-90%)

- Broad Market Maturity Portfolio(s): The maximum effective maturity of any single security should not exceed 30 years. The dollar weighted average duration of the fixed income portfolio should be within ±25% of the dollar weighted average duration of the fixed income style index. There will be no maturity restriction for the preferred stock portfolio managed by National Investment Services due to the long-term nature of preferred stocks;

- Short- to Intermediate-term Maturity Portfolio(s): The maximum effective maturity of any single security should not exceed 10 years. The dollar weighted average duration of the fixed income portfolio should be within ±25% of the dollar weighted average duration of the fixed income style index;

3. All rating categories, include qualifiers "+" and "-" for S&P and "1", "2" and "3" for Moody's. In the event of a "split rated" security, that is a security with non-equivalent rating classifications from different rating agencies, the lower of the quality ratings shall apply.

- Boyd Watterson Ultra Portfolio and National Investment Services Preferred Portfolio Only: In addition to the stated Fixed Income Diversification Requirements, Boyd Watterson may also purchase non-investment grade bonds, 144A private placements, and non U.S., but dollar denominated fixed income securities. The benchmark to be used to measure performance of this portfolio shall be the Merrill Lynch Corporate Government and Mortgage Index (formerly the Merrill Lynch U.S. Domestic Master Bond Index). A minimum of B- rating is required for High Yield and Foreign Denominated securities in the Ultra Enhanced Portfolio and the NIS Preferred Portfolio. A maximum of 30% B- rated securities is permitted in the Ultra Enhanced and NIS Preferred Portfolios.

- Mortgage backed securities may be purchased on a "when issued" or "TBA" basis (a forward contract transaction for mortgage backed issues that are to be issued in the near term). A short-term investment can back a "when issued" commitment as long as its effective duration does not exceed 180 days. These short-term investments should be considered within the fixed income allocation of the portfolio;

- Collateralized mortgage obligations are limited to securities that are currently paying interest, receiving principal paydowns and do not contain leverage. CMO's are limited to no more than 20% of the market value of the portfolio;

- No more than 20% of the market value of the fixed income portfolio may be invested in zero coupon bonds;

- Purchases of mortgage securities whose payment represents the coupon payments on the outstanding principal balance of the underlying mortgage-backed security and pays no principal (e.g. interest only securities) are prohibited;

- Mortgage securities whose payment represents the principal payments on the outstanding principal balance of the underlying mortgage-backed security and pays no interest (e.g. principal only securities) are prohibited;

- Purchases of mortgage securities whose payment of interest is determined by an index opposite to the changes in a market index (e.g. inverse floaters) are prohibited.

Cash and Equivalents

It is generally expected that the investment manager will remain fully invested in equity or fixed income securities; however, it is recognized that cash reserves may be utilized from time to time to provide liquidity or to implement some types of investment strategies. Cash reserves shall be held in the custodian's money market fund[4], short-term maturity Treasury securities, or high quality money market instruments.

4. Investments in money market funds other than the custodian's money market fund must be approved by the Pension Board prior to purchase. For investments in mutual or commingled funds, the prospectus or Trust documents of the fund(s) will govern the investment policies of the fund investments. Accordingly, it is understood that the investment manager for the separately managed account shall not be responsible for the investments in the fund.

D. Exclusions

For mutual and other commingled funds, the prospectus or Trust documents of the fund(s) will govern the investment policies of the fund investments.

Investment managers, however, shall be guided by the general principles and constraints outlined in this investment policy. The Funds' assets in separately managed accounts may not be used for the following purposes:

- Short Sales;
- Purchases of letter stock, or direct payments
- Leveraged transactions;
- Commodities transactions;
- Puts, calls, straddles, or other option strategies;
- Purchases of real estate, oil and gas properties, or other natural resources related properties with the exception of Real Estate Investment Trusts or marketable real estate securities;
- Investments in tax-exempt securities;
- Investments in limited partnerships except for publicly traded Master Limited Partnerships, the Boyd Watterson Limited Duration Mid-Grade Fund, the NIS Preferred Stock Fund, and the IDR Institutional Lending Partners Fund.
- Investments in futures, use of margin, or investments in any derivatives not explicitly permitted in this policy statement;
- Investments by the investment managers in their own securities, their affiliates, or subsidiaries (excluding money market or other commingled funds as authorized by the Pension Board).

The investment manager acknowledges the general guidelines presented in this investment policy and will seek to manage the portfolio in accordance with these guidelines. The investment manager will monitor the portfolio and will use its best efforts to correct any deviations from these guidelines as soon as reasonably practicable.

Any other security transaction not specifically authorized in this policy statement, unless approved, in writing, by the Pension Board. Requests by investment managers to execute transactions that are not currently authorized in this policy should be made prior to executing such transactions.

Transactions or unanticipated market actions that cause a deviation from these policy guidelines shall be brought to the attention of the Pension Board by the investment manager prior to executing transactions, when practical. Such deviations may be authorized in writing by the Pension Board, which can determine if the deviation constitutes a material departure from the spirit of this policy.

X. INVESTMENT TRANSACTIONS

For separately managed accounts only:

Trading for the Funds is directed by and is the responsibility of each investment manager to whom the Pension Board has granted the discretionary authority to determine (subject to the investment objectives and policies outlined herein) the securities to be bought or sold on behalf of the Funds, the amount of such securities, and the brokers or dealers to be used in such transactions. The investment manager is generally obligated, absent the Pension Board's direction to the contrary, to effect transactions with or through those brokers or dealers that in the investment manager's view, are capable of providing best price and execution of client orders.

XI. MEETINGS & COMMUNICATIONS

For separately managed accounts:

- As a matter of course, each investment manager shall keep the Pension Board or their Investment Consultant apprised of any material changes in the investment manager's outlook, investment policy, and tactics;
- A representative of each investment manager shall meet with the Pension Board or their Investment Consultant on a semi-annual basis to review and explain their portfolio's investment results;
- A representative of each investment manager shall be available on a reasonable basis for telephone communication when needed;
- Any material event that affects the ownership or capital structure or any material event that affects the management of this account (such as changes in senior investment personnel) must be reported promptly to Pension Board or their Investment Consultant. This requirement does not include routine employee stock ownership transactions or partnership announcements;
- The Investment Consultant will provide written performance reports for each separately managed account portfolio and for the composite of the Funds, including the performance of any commingled or mutual funds;
- The custodian shall provide monthly statements of assets and transactions.

XII. PERFORMANCE EVALUATION

As noted above, the Pension Board will monitor the performance of the investment managers and of the composite of the Funds on a quarterly basis.

The Pension Board will evaluate each investment manager's success in achieving the investment objectives outlined in this document over at least a three- to five-year time horizon. The Pension Board realizes that most investments go through cycles. Therefore, there will be periods of time in which the investment objectives are not met or when some investment managers fail to meet their expected performance targets.

The Funds' (and investment manager's) performance should be reported in terms of rate of return and changes in dollar value. The returns should be compared to appropriate market indexes and peer group universes, for the most recent quarter and for annual and cumulative prior time periods.

The Funds' asset allocation in separately managed accounts and the allocation to each commingled fund should also be reported on a quarterly basis (for the purposes of calculating the asset allocation of the Funds as a whole, the asset allocation of each commingled fund shall be assumed to be fully invested in the policy index to which it is compared).

Risk as measured by volatility, or standard deviation of quarterly returns, shall be evaluated after twelve quarters of performance history have accumulated. An attribution analysis* shall also be performed for the separately managed accounts, to evaluate how much of the Funds' investment results are due to the investment managers' investment decisions, as compared to the effect of the financial markets. It is expected that this analysis will use the "style index" as the performance benchmark for evaluating both the returns achieved and the level of risk taken.

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5. Performance attribution measures include, but are not limited to, the "stock selection score" and "asset allocation score". These attributions measure the value added (or subtracted) versus the manager's policy index that is attributable to individual security selections and weightings that are different from the policy index standard. The asset allocation score measures the value added (or subtracted) by not continually rebalancing the asset allocation of the manager's portfolio back to the implied asset allocation of the manager's policy index.

Guidelines for Corrective Action

The Pension Board recognizes the importance of a long-term focus when evaluating the performance of investment managers. The Pension Board understands the potential for short-term periods when the performance of individual managers may deviate significantly from the performance of representative market indexes. The Pension Board, however, may require an extra level of scrutiny, which may include termination, of an investment manager based on the following conditions:

- Any material event that affects the ownership or capital structure of the investment management firm, or the management of this account (such as described in Section XI). Failure on the part of the investment manager to notify the Pension Board or the Investment Consultant may be grounds for termination;

- Any material client servicing deficiencies, including a failure to communicate in a timely fashion significant changes as outlined in Section XI of this investment policy;

- Violation of terms of contract without prior written approval of the Pension Board constitutes grounds for termination;

- Diversification strategy – as part of its overall asset allocation strategy, the Funds will utilize a multi-manager structure of complementary investment styles and asset classes to invest the Funds' assets. Therefore, it is very important that investment managers remain consistent with the intended investment style at that time the manager was engaged;

- The Pension Board will not as a rule terminate an investment manager on the basis of short-term performance. If the organization is sound and the firm is adhering to its investment style and approach, the Pension Board will allow a sufficient interval of time over which to evaluate performance. The Pension Board expects that the Investment Consultant will provide guidance to the Committee to determine an appropriate length of time. The investment manager's performance will be viewed in light of the firm's particular investment style and approach, keeping in mind at all times the Funds' diversification strategy as well as the overall quality of the relationship;

- Investment manager may be replaced at any time as part of an overall restructuring of the Funds. The Pension Board reserves the right to terminate an investment manager for any other reason in accordance with any applicable investment management agreements.

XIII. APPROVAL

It is understood that this investment policy is to be reviewed periodically by the Pension Board to determine if any revisions are warranted by changing circumstances including, but not limited to, changes in financial status, risk tolerance, or changes involving the investment managers. Should the Pension Board permit a deviation from this policy or implement a change in policy, the circumstances and rationale for the change shall be documented and attached to this investment policy.

The Pension Board understands and agrees that the provisions of this document are subject to any relevant investment advisory agreement and to the extent of any conflict the terms of the investment advisory agreement controls. The Pension Board further understands that this investment policy statement does not provide any additional rights other than those that are described in the investment advisory agreement.

Chairman, Pension Board   Date

Deviations from the investment policies and constraints outlined in this document may be authorized in writing by the Pension Board, which can determine if the aggregate deviation constitutes a material departure from the spirit of this investment policy.

The investment policy as set forth in this document will be reviewed periodically by the Pension Board, which can approve and implement changes. If at any time the investment manager believes that these objectives cannot be met or that the investment guidelines constrict performance, the Pension Board should be so notified in writing. By initial and continuing acceptance of these objectives and guidelines, the investment manager agrees to abide by the provisions of this document effective as of________, 2014.

Investment Manager