

INVESTMENT POLICIES AND PROCEDURES TABLE OF CONTENTS

1.0 PURPOSE (Page 2)

2.0 GOALS AND OBJECTIVES (Page 2)

3.0 INVESTMENT PHILOSOPHY (Page 2)

4.0 PORTFOLIO PERFORMANCE MEASURES (Page 3)

5.0 ASSET ALLOCATION (Page 3-4)

6.0 MANAGER SELECTION, GUIDELINES, RETENTION, AND REVIEW (Page 4-6)

7.0 OPERATIONAL PROCEDURES (Page 6-7)

8.0 MINORITY AND/OR WOMAN OWNED INVESTMENT MANAGEMENT COMPANY
POLICY (Page 7-8)

1.0 PURPOSE

The purpose of this Investment Policy and Procedures is to assist the Board of Trustees of the Houston Firefighters' Relief and Retirement Fund (Fund) in the investment management of the Fund assets. The authority to amend these policies and procedures rests solely with the Board. The Investment Committee is a committee of the whole Board and has the authority to act on all matters related to investments.

2.0 GOALS AND OBJECTIVES

The primary goal of the Fund investment program is to provide sufficient investment returns with commensurate levels of risk necessary to pay the benefits promised by the Board to the Fund participants and beneficiaries. Associated with this goal is the Board's objective to maintain a fully funded status with regards to the Fund actuarial rate.

3.0 INVESTMENT PHILOSOPHY

In developing the investment program, the Investment Committee is guided by a set of precepts from which all investment decisions are made and establishes the foundation and direction for all future activity. These precepts are applied by the Investment Committee, knowing the importance of asset allocation and the benefits of diversification. These guiding precepts are as follows:

- A) Long-term Focused - The Investment Committee recognizes the long-term nature of the Fund liabilities and an appropriate investment program should have long-term assets and strategies, generally assumed to target a ten-year planning horizon.
- B) Value-Driven - The Investment Committee shows preference in buying lower-priced out-of-favor assets as a less risky approach to investment management, but will maintain an appropriate exposure to growth to enhance portfolio diversification.
- C) Relationship-Driven - The Investment Committee believes significant non-quantifiable benefits accrue to the Fund by fostering successful long-term relations with the many service providers associated with the investment management program.
- D) Opportunistic - The Investment Committee can react with flexibility and agility to take advantage of investments which have a short decision time but exhibit an above-market opportunity, so long as proper due diligence is completed.
- E) Contrarian - The Investment Committee is willing to be different from other investors by considering investments, which are unconventional or may not be the current consensus thinking as long as the investment opportunity meets the previously mentioned guiding precepts.

The Investment Committee has adopted a predominately active manager based philosophy in the belief that over a long-term horizon active management will provide excess risk-adjusted performance over passive strategies.

4.0 PORTFOLIO PERFORMANCE MEASURES

The performance objective of the Fund is to meet or exceed the actuarial rate plus Fund expenses, currently 8.5% plus 75 basis points, over a long-term horizon. For planning purposes, the time horizon is defined as ten years. To assess the performance of the overall Fund, the Investment Committee has established a target mix portfolio, which is reflective of the most recently approved asset allocation study. The target mix portfolio will consist of the following asset class weightings and related indices, which are representative of the Fund's current asset allocation:

<u>Asset Class</u>	<u>Weight</u>	<u>Index</u>
Domestic Equities	22%	Russell 3000
International Equities	22%	MSCI All Country World Ex-US Index
Fixed Income	36%	Lehman Universal Index
Alternative Investments	12%	15% Absolute Return
Real Estate	6%	9.25% Absolute Return
Cash	2%	Merrill Lynch 1-Year Treasury-Bills

5.0 ASSET ALLOCATION

The Investment Committee has allocated the assets of the Fund to several asset classes with the objective of optimizing the investment return of the Fund within the framework of acceptable risk and diversification. Each asset class is allowed to operate within its specific range established by the Investment Committee. In addition, a strategic allocation has been established for each asset class for the purpose of semi-annual performance evaluation and asset rebalancing. If a public, non-cash asset class reaches an endpoint of its allocation range; the Investment Committee shall complete a rebalance to within 2.5% of the Strategic Allocation within 90 days and upon completion, review a further move toward the Strategic Allocation. Current asset classes, asset class ranges, and strategic allocations are as follows:

<u>Asset Class</u>	<u>Asset Class Range</u>	<u>Strategic Allocation</u>
Domestic Equities	15% - 25%	22%
Int'l Equities	15%-25%	22%
Fixed Income	30% - 40%	36%
Alternative Inv.	11% - 18%	12%
Real Estate	4% - 7%	6%
Cash	0.5% - 2%	2%

6.0 MANAGER SELECTION, GUIDELINES, RETENTION, AND REVIEW

To assist the Investment Committee in the investment management of the Fund assets, managers will be retained to implement the strategies selected by the Investment Committee. This policy section will address the manager selection process, the guidelines applicable to managers hired by the Fund, and the review and retention procedures for managers retained by the Investment Committee.

A) Manager Selection

The Investment Committee uses the processes listed below to select managers depending upon the asset class placement under consideration. The examples listed as sources and filters may be modified as appropriate.

1) Public Market Investments

- a) Investment Committee decides specific asset class placement.
- b) Investment staff identifies candidate managers through databases and other sources, develops appropriate filters such as product type, risk-adjusted performance comparisons, and assets under management to narrow list, and present Request for Proposal (RFP) list to Investment Committee for approval. Once the Investment Committee has approved the RFP list of candidates, additions to the list will not be considered.
- c) Investment staff analyzes proposals, ranks candidates through additional filters approved by the Investment Committee such as investment philosophy, manager strengths and weaknesses, personnel changes, and expense control and presents analysis to Investment Committee.
- d) Investment Committee selects presentation finalists.
- e) Upon completion of presentations, Investment Committee selects on-site visitation candidates. All Investment Committee members are strongly encouraged to participate in the on-site visits.
- f) Upon completion of on-site visits, Investment Committee selects final manager for asset placement.

2) Alternative and Real Estate Investments

- a) Investment staff reviews proposals and determines appropriateness according to investment philosophy, asset allocation ranges, and capital availability.
- b) Investment staff and consultant due diligence is performed on investment opportunities of those candidates who have not previously received commitments by the Fund for similar investment strategies. Consultant due diligence is not required for follow-on or subsequent investments by candidates previously receiving commitments in a similar strategy, although a consultant review may be requested by the Investment Committee.
- c) A presentation is given by the candidate, if requested by the Investment Committee, regarding the proposed investment.
- d) The Investment Committee decides whether to approve proposed investment along with commitment level.

3) Cash

- a) Cash management is performed by the custodian bank or a related affiliate.
- b) Changes to custodian and cash manager require Investment Committee approval.

B) Manager Guidelines

Manager guidelines include general guidelines applicable to all managers and specific guidelines unique to each manager.

1) Public Market Investments

- a) The specific guidelines for each manager will be developed cooperatively by the Investment staff, legal counsel, and manager and shall be incorporated into the Investment Management Services Contract executed by the Chair, Executive Director, and the manager consistent with the Investment Committee's direction.
- b) In case of conflict between the specific manager guidelines and the general guidelines, the specific guidelines, as approved by the Investment Committee, shall supersede. The general guidelines are as follows:
 - i. Manager investment philosophy, style, and strategy shall remain consistent and shall not change without the Investment Committee's approval. The manager shall have discretion to manage the portfolio consistent with the style presented to the Investment Committee at the time of selection and further subject to the restrictions established by the policy herein.
 - ii. The following transactions are prohibited: short sales, selling on margin, put and call options, and the use of derivatives for speculation unless authorized by the Investment Committee.
 - iii. Transactions that involve a broker acting as a principal, where such broker is also affiliated with the manager who is making the transaction are prohibited, unless specifically approved by the Investment Committee.
 - iv. Transactions shall be executed at competitive costs, or within the parameters established for directed brokerage transactions by the Investment Committee.
 - v. Managers shall maintain cash levels consistent with their style as presented to the Investment Committee at the time of selection. Any deviation shall be allowed only after notifying the Chief Investment Officer and Executive Director and should be related to unusual market conditions. The cash level held by each manager will be addressed in the Investment Management Services Contract.

2) Alternative and Real Estate Investments

- a) The investment specific guidelines for each manager will be incorporated in a Limited Partnership Agreement, Limited Liability Company Agreement, or other binding agreement as is appropriate for the investment. Chair and the manager execute this document.
- b) In case of conflict between the specific manager guidelines and the general guidelines, the specific guidelines, as approved by the Investment Committee, shall supersede. The general guidelines are as follows:
 - i. Manager investment philosophy, style, and strategy shall remain consistent and shall not change without the Investment Committee's approval. The manager shall have discretion to manage the portfolio consistent with the style presented to the Investment Committee at the time of selection and further subject to the restrictions established by the policy herein.

- ii. The Chair may execute amendments and consents if the resulting changes or allowances are provided for in the governing documents as previously accepted by the Investment Committee. Otherwise, such changes are to be approved by the Investment Committee. Investment Committee will be notified on a quarterly basis of all executed amendments.

C) Manager Retention

Upon selecting a manager for placement of Fund assets, the Investment Committee's intent, according to the relationship-driven precept detailed in Section 3.0, is to develop and maintain a successful long-term relationship with the manager.

1) Public Market Investments

The Investment Committee with assistance from the investment staff shall monitor each manager's performance and adherence to style, strategy, and manager specific guidelines. It is the Investment Committee's discretion to take corrective action by replacing a manager if they deem it appropriate at any time.

a) Quantitative Measures - In monitoring performance of each manager, the investment staff will determine linear regressions of gross monthly time-weighted data to the appropriate benchmarks as indicated in the respective Investment Advisory Agreement. From these regressions, coefficients of determination, beta, and alpha are monitored on rolling three-year periods. If the rolling alpha is less than the manager fees (in basis points), then staff will present quarterly reports to the Investment Committee and measurable improvement is required over the ensuing 12-month period. If no improvement is detected over the ensuing 12-month period, then the investment staff will recommend appropriate action and remedies, if any, to the Investment Committee.

b) Qualitative Measures – The Investment staff shall notify the Investment Committee of changes occurring in the key portfolio management of a firm, significant account losses, significant growth of new business, a change in firm ownership, or other organizational changes. After identifying a significant event impacting a firm, the investment staff will recommend appropriate action and remedies, if any, to the Investment Committee.

c) Performance Measures - The performance objective for each manager retained by the Fund is to provide a three-year rolling alpha in excess of the manager's fees. For determining the linear regression statistics, the benchmarks should be followed in accordance with the manager's style and strategy as documented in the Investment Advisory Agreement.

2) Alternative and Real Estate Investments

The Investment Committee with assistance from the investment staff shall monitor each Alternative and Real Estate manager's performance and adherence to strategy and manager specific guidelines. Quantitative, Qualitative, and Performance measures shall be monitored as are appropriate to each investment.

- a) Alternative and Real Estate investment manager retention is governed in most cases by Limited Partnership Agreements, Limited Liability Company Agreements, or other binding agreements. In these cases, the Investment Committee with assistance from the investment staff shall identify available options as allowed by the governing documents and determines the impact and

consequences of these options. It is the Investment Committee's discretion to take corrective action by replacing a manager if they deem it feasible and appropriate at any time.

D) Manager Review

All Public Market Investment active managers shall make a presentation before the Investment Committee once per year to review the account under management. Additional manager reviews shall be made semi-annually to the Investment Committee through the Investment staff presentation of materials pertaining to manager performance and cash management practices. Passive managers, Alternative Investment Managers, and Real Estate Managers shall be reviewed as requested by the Investment Committee. Additional manager reviews shall be made quarterly to the Investment Committee through the Investment staff's presentation of materials pertaining to manager performance and cash activity. More frequent manager reviews of any asset class or manager may be requested by the Investment Committee as needed.

7.0 OPERATIONAL PROCEDURES

- A) Asset and/or foreign currency distributions from Alternative or Real Estate Investments with a market value less than 0.25% of total Fund assets may be liquidated by the Chief Investment Officer, with written approval of the Chair and the Executive Director. Since the Investment Committee views these assets as a return from the Alternative or Real Estate investment and does not intend to contribute these assets to other asset class managers, these assets should be liquidated in a prudent and timely manner. Furthermore, since the Investment Committee does not actively manage currency internally and does not intend to contribute foreign currencies to the international equity allocation, these positions should also be liquidated in a prudent and timely manner. The Chief Investment Officer may defer immediate liquidation if market, sector, or company specific knowledge provides a reasonable expectation of value improvement through a longer holding period. Should the Chief Investment Officer decide to hold the asset or currency position in excess of 180 days, or is unable to liquidate the asset within this time period then the Investment Committee shall be advised at the next Investment Committee meeting.
- B) Securities Lending
The Investment Committee has authorized the custodian bank, through a securities lending agreement, to engage in the lending of the Fund securities for the purpose of generating income from the investment of the related collateral. The income is divided between the Fund and the custodian bank according to the Custodial Bank Contract. The Investment Committee has elected to participate in the securities lending program of the custodian bank because of the more stringent broker/dealer controls provided by the bank. This approach offers a more secure lending program though less profitable than other programs with less rigid broker standards.
- C) Directed Brokerage
The Investment Committee has implemented a directed brokerage commission recapture program for the purpose of lowering the Fund's transactions costs. Brokers have been selected by the Investment Committee who are capable of providing quality transaction service to the Fund managers and have a designated history of delivering recaptured

commission income to plan sponsors. The investment staff monitors the program and ensures that the recaptured income is directed into the manager's account according to the commissions generated and the recapture rate negotiated with the brokers used by the manager.

D) Cash Management

The Chief Investment Officer is allowed the discretion to use the STW B Short-Intermediate Bond Portfolio to manage the cash level within the established asset class range. If cash rises/falls above/below the asset class limit, the STW B portfolio will be bought/sold to bring the cash within the range and staff will provide monthly activity reports to the Investment Committee. The Chief Investment Officer may not reduce the STW B portfolio below \$75 million without approval from the Investment Committee.

8.0 MINORITY AND/OR WOMAN OWNED INVESTMENT MANAGEMENT COMPANY POLICY

In keeping with the Board's commitment to equal opportunity for all people and firms, without regard to the race, color, national origin, religion, sex, age or disability of the person or the firm's principals, employees or associates, the Investment Committee has approved the following Guidelines.

Guideline 1: The Committee shall determine whether a firm is minority, women or disabled owned (MWDBE) by using the then-current City of Houston guidelines.

Guideline 2: A firm shall be considered "local" if: (1) the firm's principal place of business or corporate headquarters is located in the greater Houston metropolitan area, without regard to the firm's state of incorporation or registration; or (2) the person(s) having a controlling interest (51% or more of the firm's ownership) in the firm live in the greater Houston metropolitan area.

Guideline 3: A firm shall be considered "small" if it had less than \$250 million in assets under management.

Guideline 4: In order to qualify for consideration for initial placement of Fund assets, a MWDBE, local or small firm shall generally be evaluated under section 10.00 of the *Policy and Procedures Manual: Investments*. However, MWDBE, local and small firms may be considered under alternative qualification standards in the following areas: (1) the firm must demonstrate that it has existed as a business entity under stable management for at least two years with sufficient assets under management to allow adequate review by the Committee, or in the case of private equity, that its key investment professionals have worked together and the offering represents the principals' only income source and the principals' equity investment in the offering represents a significant percentage of their net worth; (2) at least three years verifiable history of performance attributable to the team proposed to manage the Fund's assets, or in the case of private equity, that the principals have a superior track record attributable to each individual and as a team; and (3) management of the firm must have control of the investment and business decision-making process.

Guideline 5: Any MWDBE, local or small firm awarded an investment contract under the alternative standards set forth above must be directly responsible for the management of

Fund assets placed under its control, but it may use outside resources in the investment process in accord with guidelines established by the Committee.

Guideline 6: Once a firm or person that qualifies as MWDBE, local or small has Fund assets placed with it for management, it shall be evaluated by the same performance objectives, performance benchmarks and evaluation procedures as all other similar investment managers.