HOUSTON POLICE OFFICERS’ PENSION SYSTEM

STATEMENT OF
POLICY, GUIDELINES
AND
INVESTMENT OBJECTIVES

SECTION 400.00
# HOUSTON POLICE OFFICERS’ PENSION SYSTEM
## INVESTMENT POLICY
### Section 400

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INTRODUCTION

The Board of Trustees of the Houston Police Officers’ Pension System (HPOPS), pursuant to statutory authority under the provisions of Article 6243g-4, and Chapter 802 of the Government Code, Tex. Rev. Cir. Stat., has been given the responsibility to administer the System for the benefit of all plan participants. In addition the Board shall:

A. Establish overall financial objectives and set investment policy;
B. Select appropriate investment options;
C. Select qualified investment manager(s) and consultants;
D. Select a qualified custodian;
E. Communicate on a structured and ongoing basis with those responsible for investment results; and
F. Monitor performance to assure that objectives are being met and that policy and guidelines are being followed.

Parties to the System and a description of their duties are set forth in Appendix A.

In accordance with Section 802.202 of the Texas Government Code and Section 10(a) of Article 6243g-4 of Vernon’s Texas Civil Statutes the Board may directly manage the assets of the System or may choose and contract for professional investment management services. The Board is responsible for investment strategy within the policy and guidelines limitations established by the Board and the Board or the Investment Manager(s) as is applicable, will be responsible for implementing individual investment strategies.

PURPOSE

This Statement of Policy Guidelines and Investment Objectives represents the formal document for HPOPS, and is to be communicated to the appointed Investment Manager(s) and is their principal source for developing an appropriate investment strategy and, in addition, serves as the basis for these Managers' and System's future performance evaluation. Any changes in this Statement of Policy and Guidelines and Investment Objectives, or exceptions to them, will be in writing and delivered to the Manager(s).
402.00 POLICY STATEMENT

402.01 The primary fiduciary fiscal responsibility of the Board is to insure that the System’s assets are responsibly managed in accordance with the actuarial needs of the System, and also with sound, generally accepted financial investment procedures. The determination of the appropriate asset mix is based on the structure of the System’s liabilities, capital market assumptions which incorporate both historical and projected returns, volatility and correlation of various asset classes as well as other economic and market risks such as liquidity risk and counterparty risk.

402.02 The Standard of Investment for the System shall be to exercise the judgment, care, skill, prudence, and diligence under prevailing circumstances that a prudent expert acting in a like capacity and familiar with matters of the type would use in the conduct of an enterprise with like character and like aims. The Board shall diversify the investments of the System to minimize the risk of large loss, unless under the circumstance it is clearly prudent not to do so. In addition the assets of the System will be invested in accordance with the documents and instruments governing the System to the extent that the documents and instruments are consistent with Chapter 802 of the Texas Government Code.

402.03 The Board of the HPOPS shall invest the assets of the System solely in the interest of the membership and their beneficiaries, and for the exclusive purpose of providing benefits to the membership and their beneficiaries and to defray the reasonable expenses of administering the HPOPS.

402.04 Because of the complexity of the investment environment, the Board has the option to retain the services of separate investment managers to manage separate portions of the System’s assets.

403.00 OBJECTIVES OF THE PLAN

403.01 The primary long-term financial goal of the System is to earn a sufficient rate of return from its assets so that the value of its assets meet or exceed its accrued liabilities (a coverage ratio greater than or equal to 1.00). In other words, the rate of return objective is the assumed actuarial investment rate at the minimum, which is currently set at 7.0% net of all fees and expenses. In addition, the System has a real rate of return objective of the System’s actuarial investment rate of return assumption less realized inflation over a full market cycle (usually 3 to 5 years).

403.02 The performance objective of the System is to achieve the highest possible rate of return from its assets within risk parameters as established by the Board.
403.03 Other objectives of the System are to control investment risk through diversification, preserve capital, meet the liquidity needs of the System, and to have no violations of applicable laws and regulations.

404.00 INVESTMENT PHILOSOPHY

404.01 The Board believes that the System’s assets should be managed in a way that reflects the uniqueness of the System. The System’s assets should be diversified over a spectrum of internally and externally managed investment vehicles. Specifically, the Board should recognize and adhere to the following philosophical positions.

404.02 The Board believes that diversification should be based upon the prudent allocation of risk rather than solely the allocation of capital. The dollar allocation of capital indicates where money is invested and does not give a very good sense of which assets are driving the asset portfolio risk and return, since some assets are much more volatile than others. Risk allocation gives a better picture of the assets driving portfolio returns.

404.03 The Board believes that asset classes are priced to have long-term expected returns above cash and their return above cash is proportional to their risk. Since asset classes have similar expected risk to return ratios, they can be made competitive through the prudent use of leverage or leverage-like techniques.

404.04 Over the long term, the risk of owning equities has been, and should continue to be, rewarded with a somewhat greater return than that available from fixed income investments.

404.05 Over the long-term fixed income investments provide the System with an investment vehicle that contributes diversification, liquidity and a predictable stream of income, and that dampens volatility in investment return.

404.06 Diversification into alternative investments provides the System certain benefits. In order to further enhance real returns over inflation, and to achieve broader diversification of the System’s assets, an allocation has been made for selected alternative investments. A partial list of acceptable alternative investments are outlined in Appendix B.

405.00 INVESTMENT OBJECTIVES

405.01 The Board believes the following objectives are reasonable and achievable over the long-term within the guidelines provided herein:

405.02 A nominal rate of return net of all fees and expenses approximating the System’s actuarial assumption.
405.03 A real rate of return equal to or in excess of the amount calculated by subtracting the inflation assumption from the rate of return assumption adopted by the Board and used in the System’s periodic actuarial valuation.

405.04 Risk management is achieved through recognition of the internal and external risks, included in but not limited to those risks described below, and the implementation of programs to address these and other risks as well as periodic monitoring and reporting on such risks.

A. External Risks

- Markets Fail to Achieve Expected Returns Implicit in the System’s Asset Allocation. This is the risk that the long-term behavior of one or more asset types turns out to be significantly different than expected due to unforeseen market, economic, or political factors.

- Legislated Actions. Examples include laws that limit what asset types public pension systems may own and legislation that increases benefit formulas without considering available assets.

- Inherent Risks. All investments are subject to one or more types of inherent risk including interest rate risk, liquidity risk, market risk, etc.

B. Internal Risks

- Strategic Risks. Decisions, usually made by the Board, to move away from underlying policy benchmarks. Examples include active versus passive management, style over or under weights, capitalization over or under weights, sector over or under weights and selection of asset types.

- Poor Governance. The risk that the Board, staff, or agents of a public pension system will, either intentionally or unintentionally through their management actions or lack thereof, cause the System’s assets to under-perform expectations and thus fail to support the System’s liabilities. Examples include codes of ethics, organizational structure and the competence of Board and Staff.

- Implementation Risk. This is the risk that policies and procedures may not be implemented properly. The System may develop and adopt the ideal asset/liability mix, asset allocation model, and investment policies and strategies, but if staff or agents of the System do not effectively implement the mix and strategies, then assets may...
ultimately not support the liabilities generated. This risk has been subdivided into Tactical and Operational components.

• Tactical Failure. This includes the risk that the actual allocation of assets does not conform to the asset allocation strategy. Secondly is the risk that the actual return experienced through investment in specific assets does not equal the returns of the asset classes of which they are a part. Examples include Portfolio Drift, Under Performance, Strategic Decisions, Manager Misfit and Manager Under-Performance.

• Operational Failure. The risk of operational failure is not primarily concerned with investment strategy or tactics, but with management and operational issues used in the implementation process of the strategy or tactic. Operational failures often result from a breakdown in systems, procedures, personnel, or processes either internally or at the System’s external managers, consultants or custodian banks.

405.05 Risk Control Policy

A. The Board recognizes that the asset mix of the System has significant exposures to asset classes that tend to outperform during periods of strong economic growth and conversely tend to underperform during periods when economic growth declines. The Board also recognizes that a policy that seeks to avoid large losses during periods of a decline in economic growth is a prudent component of any investment strategy. For these reasons, the Board has adopted a Risk Control Program that requires the Board to be informed in the event one of the economic and financial metrics below signals caution and requires a meeting of the Board and Staff when two or more of the metrics indicate that a period of economic or market decline may be imminent or in progress. The metrics that are monitored are as follows:

• Third Party Business Cycle Indicators
• Staff Business Cycle Component Monitor
• S&P 500 Moving Average
• Risk Tolerance Indicator
• Credit Spreads
• Drawdown Control Mechanism

B. Staff will monitor these metrics and inform the Board if one metric is triggered. At such time when two or more metrics are triggered, a special meeting of the Board will be convened, unless a regular meeting of the Board is already scheduled within the next five business days.
C. In recognition of the fact that significant investment losses can be realized in a time frame that is too short to be effectively addressed by a special Board meeting, the Executive Director has the authority to reduce the System’s equity according to the Board approved sliding scale below, if one or more of the risk metrics established in the System’s risk control program is “triggered.”

<table>
<thead>
<tr>
<th>Leverage Range</th>
<th>Allowed Reduction as % of Leverage</th>
<th>Allowed Reduction as % of Total Assets</th>
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<tbody>
<tr>
<td>9.00% - 9.75%</td>
<td>-36%</td>
<td>-3.50%</td>
</tr>
<tr>
<td>8.00% - 9.00%</td>
<td>-37%</td>
<td>-3.30%</td>
</tr>
<tr>
<td>7.00% - 8.00%</td>
<td>-39%</td>
<td>-3.10%</td>
</tr>
<tr>
<td>6.00% - 7.00%</td>
<td>-41%</td>
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</tr>
<tr>
<td>5.00% - 6.00%</td>
<td>-45%</td>
<td>-2.70%</td>
</tr>
<tr>
<td>4.00% - 5.00%</td>
<td>-50%</td>
<td>-2.50%</td>
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<tr>
<td>3.00% - 4.00%</td>
<td>-50%</td>
<td>-2.00%</td>
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<tr>
<td>2.00% - 3.00%</td>
<td>-50%</td>
<td>-1.50%</td>
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<tr>
<td>1.00% - 2.00%</td>
<td>-50%</td>
<td>-1.00%</td>
</tr>
<tr>
<td>0.00% - 1.00%</td>
<td>-100%</td>
<td>-1.00%</td>
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</table>

D. The liquidity of the System is a priority for the Board. In recognition of the fact that market losses can impair the System’s cash position through exposures in the cash overlay program, the Executive Director has the authority to suspend the cash overlay program if one or more risk metrics established in the System’s risk control program is “triggered.”

405.06 Liquidity Risk

A. The overall liquidity objective of the System is to provide ample liquidity to meet benefit payments and investment strategy funding requirements.

B. Staff shall structure the System’s investments to provide the flexibility to operate in all types of market environments while achieving targeted rates of return and asset allocation objectives.

C. Leverage in the System’s equity futures accounts shall not exceed 200 percent of collateral.
D. Staff may temporarily increase the System’s leverage to meet short-term liquidity requirements.

E. In order to manage the System’s liquidity and financing needs, the Executive Director is authorized to execute the documents necessary to secure a line of credit from the System’s custodian bank for a maximum of $100 million and a maximum term of three years.

406.00 ASSET ALLOCATION

406.01 The assets of the System shall be invested with a view toward the long term in order to fulfill the obligations promised to the participants and beneficiaries as well as to control risk and future levels of funding. The objective of the guidelines for asset allocation is to maximize the return on the System’s assets with acceptable levels of risk.

406.02 Recognizing the objectives of HPOPS, the System’s asset allocation will be implemented in accordance with asset allocation structures as periodically approved by the Board of Trustees and approved in the minutes of a meeting of the Board of Trustees.

406.03 The Board has by formal action adopted asset allocation targets. The Board shall determine on an appropriate basis the number and type of internally managed strategies and external investment managers for each asset class. The Board recognizes the need to rebalance the asset mix in order to bring each asset class in line with the target goal and to allocate the asset mix within the target ranges. Policy and guidelines for asset rebalancing are presented in Appendix C.

406.04 The criteria for the selection of investment managers will be determined by the Board with the assistance of their Staff. Such criteria are set forth in Appendix D. The procedure for manager searches appears in Appendix E.

407.00 INVESTMENT GUIDELINES

407.01 Consistent with these Guidelines, full discretion is granted to the investment managers with respect to the diversification, risk management, selection of securities and the timing of investments in accordance with industry best practices for a plan of this type and the manager’s contractual and fiduciary obligations. Specifically, adherence to the “prudent expert” standards is required. Further, all assets are to conform to the specific Texas laws governing these investments.

407.02 The Board expects that there will be short-term periods during which real and nominal rates of return objectives cannot be met because of general security
market conditions or general economic conditions or both. The Board does not wish to change investments or risk exposures to attempt to meet the stated objectives over abbreviated periods unless such change is authorized by the Board through the execution of either internally or externally managed investment strategies, or unless such change is authorized by an individual manager’s specific strategy in the case of externally managed strategies. The investment managers are to devote attention to sound, long-term investment planning for the benefit of the System. While keeping in mind relative performance goals, investment managers must avoid becoming guided by a narrow investment strategy simply because it has been successful in the past. Managers must adhere to their professed investment styles at all times and must adhere to the guidelines in the following sections unless specifically excepted by contract or by Board authorization.

407.03 Public Equity Investments

A. The Board is concerned about equity market volatility and wishes to avoid portfolio compositions that might lead to a substantial decline in market value in any fiscal year, even under extraordinarily bad market conditions. Although the Board expects each individual portfolio to be fairly diversified so as to minimize the risk of large losses, unless it is clearly prudent not to do so, the overall diversification is to be achieved by the Board with their selection of either internally or externally managed investment strategies.

B. For each portfolio, the maximum allocation to any one single equity issue is 15% of the total portfolio at market value; and any equity issue held in the portfolio must not exceed 5% of the issued and outstanding shares of common stock in the issuer corporation. Passive equity portfolios are not subject to these two limitations. The Board expects each portfolio to be fully invested at all times. Cash and cash equivalents must not exceed 5% of the total portfolio for any extended period of time unless permitted by contract.

C. Public equity strategies can be internally or externally managed and can consist of commingled funds, mutual funds, separate accounts, ETFs or special purpose vehicles.

D. Currency exposure may be hedged at either the manager or total fund level.

407.04 Fixed Income Investments

A. Over the long term, fixed income investments should provide a positive cash flow to the System, dampen the volatility of the System, and provide positive real returns even on a short time horizon.
B. Dynamic, flexible management of the total fixed income portfolio is both permitted and encouraged. Shifts of emphasis among various security types, risk exposures, sectors and short-term investments should be carried out at the discretion of the investment Staff or the investment managers as is applicable. For purposes of identification, short-term cash investments are defined as any fixed income security purchased within one (1) year of its maturity date.

C. Fixed income securities are subject to various risks. Among them are interest rate risk, reinvestment risk, credit risk, inflation risk, liquidity risk, political risk, currency risk, and event risk. Investment managers have full discretion in adopting investment strategies to deal with these risks within the constraints of their contractual agreement with the System.

D. The Board expects managers to perform due diligence analysis on each security, since each investment decision is to be based on its own merit. Each security selected is to be subjected to thorough financial analysis by the manager to determine its suitability for investment. Reliance on one or more of the rating agencies is prohibited. A thorough review of the credibility of the rating assigned to the security is to be completed prior to committing the System’s assets and frequent reviews of this nature should be performed periodically after commitment.

407.05 Alternative Investments

A. These investments tend to have a much longer investment time horizon than other asset classes. The following are general guidelines on alternative investments.

B. Subject to a specific exception approved by the Board, these investments should be diversified by subclass, investment manager, geographic location, industry, and timing of investments. The general partners or sponsors of alternative investment funds (usually in the form of limited partnerships) must possess the management skill and industry knowledge in order to exercise influence or have an impact on the portfolio companies owned by the funds.

C. Generally, the minimum investment committed for any of these investments is $35 million.

D. The Board may engage a consultant for these investments. The operating procedure for individual investment is described in Appendix I.
Securities distributed in kind from these investments will be disposed of in an orderly manner under the direction of the Executive Director and the Chief Investment Officer.

407.06 Private Equity, Real Estate and Real Assets

A. These strategies are generally in a limited partnership structure and can be either a draw-down structure or an open-ended structure.

B. Investment can be in the form of direct limited partnership interests, co-investments, commingled funds, special purpose vehicles, separate accounts or secondary market transactions.

C. The primary long-term objective of the Private Equity and Real Estate Portfolios is to develop a prudently diversified portfolio of investments that is expected to enhance the overall risk-return profile of the Total Fund and to reduce risk within the Private Equity and Real Estate Portfolios.

D. Committed but undrawn capital shall be invested in accordance with the System’s asset allocation targets subject to liquidity constraints and tactical adjustments of up to twenty-five percent of such amounts.

E. HPOPS Staff, or a consultant designated by the System, may serve on an advisory board, or similar advisory body to a HPOPS investment vehicle.

F. In recognition of the extensive administrative requirements for this asset class, the Board allows for the processing of term extensions and right of first refusal elections as follows:

Term Extensions: The Executive Director is authorized to execute amendments to extend a fund’s life for a one year period, provided the GP is no longer charging fees, there are no exigent matters involving the GP or the remaining investments of the fund and the System has received a recommendation to approve the extension from its consultant.

Right of First Refusals: Right of First Refusal elections are not required to be presented to the Board unless Staff or the System’s consultant believe that the investment opportunity represents an attractive return at an
acceptable level of risk. A report issued by the consultant accessing the opportunity will be obtained and kept in the System’s records database.

407.07 Risk Parity

A. Risk Parity or, structured beta, strategies can take the form of commingled vehicles, separate accounts, or overlay structures.

B. The strategies diversify risk across various economic environments and risk premiums through a leveraged combination of derivatives and cash investments.

C. The Executive Director has the discretion to decrease the target volatility in the System’s risk parity strategies by up to 25 percent.

407.08 Hedge Funds and other Alternatives

A. Hedge funds are private funds that generally take the form of a partnership or special purpose vehicle. Hedge fund risks generally consist of liquidity risk, leverage risk, valuation risk, concentration risk, security selection risk, manager risk, as well as other types of risk.

B. Investments in hedge funds can take the form of individual funds or fund of funds vehicles.

C. Hedge fund strategies can consist of arbitrage strategies, multi-strategy, long/short, market neutral, global macro, and other strategies.

D. Hedge fund strategies can be selected by the Board and Staff or with the assistance of an advisor and the resulting portfolio should be diversified by risk exposure, liquidity terms, and by manager.

E. The System may invest in externally or internally managed option trading strategies, hedging strategies, portable alpha or risk management strategies as approved by the Board.

407.09 Credit Managers

A. Credit strategies consist of high yield, illiquid credit and opportunistic credit-oriented strategies.
B. The credit portfolio should be diversified by strategy, liquidity, and manager.

C. Assets committed to but not yet invested in credit strategies shall be invested in accordance with the System’s asset allocation targets with variations subject to liquidity constraints or tactical allocations as approved by the Board.

407.10 Cash

A. The investment objective for Cash shall be to invest in a portfolio of short-term securities to maximize current income while preserving capital.

B. An overlay strategy may be implemented to securitize cash exposures to be determined by the Board.

407.11 General

A. When the System participates in a mutual fund or commingled fund, the investment guidelines of the mutual fund or commingled fund shall supersede those of the System where a difference exists.

B. Domestic equity and international equity investment managers shall not purchase lettered stock or private placements (i.e., issues which may have subsequent sales restricted by law or issues which there is no ready liquid market) unless permitted to do so under the manager’s investment guidelines.

C. The use of stock options, puts or calls, are not permitted without the prior written consent of the Board unless permitted to do so under the manager’s investment guidelines. Managers hired specifically for a stock option writing program are deemed to have the prior written consent of the Board. Such managers shall be subject to certain specific guidelines to be included in the investment management contracts.

D. Investment managers shall limit the use of commingled funds and mutual funds to those where a comparable investment yielding comparable investment results cannot be obtained on a separately managed basis, unless permitted to do so under the manager’s investment guidelines.

E. Investment managers shall seek written approval from the Board for any deviations or exceptions from the investment guidelines as set forth in this Section and the investment manager agreements or the investment guidelines of the mutual fund or commingled vehicle.
F. Excess cash shall be securitized in a ratio approximating the System’s asset allocation mix. When the three-month moving average of the VIX is above 23 then securitization mix will be one hundred percent fixed income and when the three-month moving average is below 14 the securitization mix will be 100 percent equity.

G. Currency exposure of each investment manager and strategy, as well as the overall currency exposure of the System, will be based upon an active decision making process as opposed to accepting currency exposure as a default position of such manager or strategy. Fifty percent of the Euro, Yen, and Pound exposure in the System’s developed non-US public equity allocation will be permanently hedged while Staff has the authority to tactically adjust this hedge with a 25% floor and a 75% ceiling.

H. Counterparty exposures of each investment manager and strategy, as well as the overall counterparty exposure of the Fund, will be actively managed and monitored by investment managers and Staff.

I. Securities Litigation shall be handled in accordance with the System’s Securities Class Action Litigation Policy.

J. All fiduciaries to the System are subject to the System’s Ethics Policy.

K. All requests for information shall be handled in accordance with the System’s Public Information Act Policy.

L. HPOPS does not have a segregated Inflation Protection Portfolio. However, HPOPS does recognize the risk of both unexpected and long-term inflation and believes that there is sufficient inflation protection imbedded in the HPOPS portfolio versus our peers and relative to the inflation sensitivity of our liabilities.

M. Certain asset categories that are often associated with inflation protection are not specifically utilized in the HPOPS portfolio:

- Commodities have volatility that seems to more than offset the potential of any inflation protection benefits as well as having low return expectations.

- TIPS can be dominated by the interest component and have low return expectations.

- Infrastructure has undesirable liquidity features.

- Gold has low return expectations and high volatility.
• Inflation sensitive equities can be volatile and it is difficult to construct a portfolio of meaningful size and diversification.

408.00 EVALUATION AND REVIEW OF INVESTMENT MANAGERS

408.01 An ongoing evaluation of the System’s investment managers is essential to assure that the assets are being invested in the best interest of the participants and beneficiaries. Evaluation and review encompasses the following:

408.02 Investment Philosophy: Review of the manager’s investment philosophy and process to identify possible deviations from the stated philosophy to ensure a continuous fit with the System’s overall strategy.

408.03 Organization: To monitor the manager’s organization and staffing to ensure that the manager will continue to function efficiently in carrying out its operations which will support and enhance the successful execution of its investment philosophy.

408.04 Compliance: To monitor compliance with all applicable laws and regulations, internal guidelines such as those relating to proxy voting and conflict of interest, and the System’s guidelines relating to directed brokerage. Compliance of performance presentation of all equity and fixed income managers is discussed in Appendix F.

408.05 Performance: On at least a quarterly basis, the Board will review actual results achieved by the Investment Managers to determine whether:

A. The Investment Managers perform in compliance with the Investment Objectives and Policy Guidelines as set forth herein; and

B. The Investment Managers meet the Standards of Measurement as set forth in Section 409.00.

408.06 Meetings: The Investment Committee of the Board, or staff, will meet at least once a year with Investment Managers on investment and related matters. The Trustees and Staff will make due diligence visits as needed to offices of Investment Managers. The objective and procedures for such visits are outlined in Appendix G.

409.00 STANDARDS OF MEASUREMENT

409.01 For the purpose of evaluating investment performance several standards of measurement will be used. This plurality of standards allows for comparison of several aspects of investment performance relative to the System’s specific
objectives, market indices and other managed funds. These standards are targeted objectives used to evaluate performance rather than absolute requirements that mandate a specific action by the Board and are subject to customization for individual managers. Staff shall maintain documentation of the periodic review of these standards. The specific standards are as follows:

**409.02 Domestic Equity:**

A. The real annual rate of return of the domestic equity portfolio over the long term shall equal or exceed the return of the Russell 3000 Index less realized inflation.

B. The nominal annual rate of return of the domestic equity portfolio over a market cycle shall meet or exceed the return of the Russell 3000 Index.

C. The nominal annual rate of return over a market cycle shall for an individual manager or strategy shall exceed the return of the specific equity index benchmark as agreed upon by both the Board and the investment manager.

D. The nominal annual rate of return over a market cycle for an individual manager or strategy shall be in the top thirty percentile of other equity managers of a similar style as agreed upon by both the Board and the investment manager.

**409.03 Equity Index Managers:**

A. The real annual rate of return of the portfolio over the long term shall equal or exceed the product’s market index less the realized rate of inflation.

B. The nominal annual rate of return over a market cycle shall equal or exceed the return of the specific equity index benchmark for which the index portfolio is modeled.

**409.04 Fixed Income:**

A. The real annual rate of return of the fixed income portfolio over the long term shall equal or exceed the benchmark established by the Board less realized inflations.

B. The nominal annual rate of return over a market cycle shall exceed the return of the benchmark established by the Board.

C. The nominal annual rate of return of an individual manager or strategy over a market cycle shall exceed the return of the specific fixed income
index benchmark as agreed upon by both the Board and the investment manager.

D. The nominal annual rate of return of an individual manager or strategy over a market cycle shall be in the top thirty percentile of other fixed income managers of a similar style as agreed upon by both the Board and the investment manager.

409.05 International Equity:

A. The real annual rate of return of the international equity portfolio over the long term shall equal or exceed the return of the MSCI ACWI ex-US (hedged) Index less realized inflation.

B. The nominal annual rate of return of the international equity portfolio over a market cycle shall exceed the return of the MSCI ACWI ex-US (hedged).

C. The nominal annual rate of return of an individual manager or strategy over a market cycle shall exceed the return of the specific equity index benchmark as agreed upon by both the Board and the investment manager.

D. The nominal annual rate of return of an individual manager or strategy over a market cycle shall be in the top thirty percentile of international equity managers of a similar style as agreed upon by both the Board and the investment manager.

409.06 Credit:

A. The real annual rate of return of the high yield portfolio over the long term shall equal or exceed a benchmark established by the Board less realized inflation.

B. The nominal annual rate of return of the high yield portfolio over a market cycle shall exceed the return of the benchmark established by the Board.

C. The nominal annual rate of return of an individual manager or strategy over a market cycle shall be in the top thirty percentile of international fixed income managers of a similar style as agreed upon by both the Board and the investment manager.
Alternative Investment Managers:

A. Risk Parity - Risk Parity strategies should have a nominal annualized rate of return over a market cycle that equals or exceeds a 60 / 40 mix of the S&P 500 Index and the Barclay’s Aggregate Index.

B. Hedge Funds

• The nominal annualized rate of return over a market cycle for a hedge fund should equal or exceed the appropriate HFRI index for the manager or fund.

• The annualized rate of return over a market cycle for the System’s hedge fund portfolio should equal or exceed the return of the MSCI World Equity Index (hedged) on a risk adjusted basis.

• The correlation of the System’s hedge fund portfolio to the MSCI World Equity Index (hedged) over a market cycle should be no greater than .5.

C. Private Equity, Real Estate, and Real Assets - The nominal annual rate of return over a market cycle shall exceed the rate of return on the S&P 500 Index by 3% to 5%.

Total Fund:

A. The real annual rate of return of the total fund over the long term shall equal or exceed the actuarial investment rate of return assumption less the actuarial inflation assumption, both as adopted by the Board.

B. The nominal annual rate of return over the long term shall equal or exceed the actuarial rate as established by State law.

C. The nominal annual rate of return over a market cycle shall exceed the policy return for the System’s assets, which is the weighted return of all the benchmarks for the various asset classes.

ADMINISTRATION

A. No System Representative shall purchase or sell a security while in possession of or with knowledge of material, nonpublic information about the security or the security’s issuer, or knowingly communicate any material, nonpublic information about a publicly-traded security or the security’s issuer obtained in the course of a Trustee’s duties as a Trustee of the System or an employee’s employment by the System,
except in accordance with the lawful performance of the Trustee’s or employee’s duties to HPOPS.

B. This prohibition applies to all System Representatives, regardless of resignation or termination, until the material, non-public information is publicly disseminated.

C. Violation will result in corrective action, up to and including termination of contract or relationship with HPOPS, discipline or initiation of removal action pursuant to any and all applicable laws, or criminal prosecution.

410.02 The Board is mindful of the necessity to hire and retain a professional Master Custodian who will act as a fiduciary in the safekeeping of the System's assets, handling of all investment transactions including, but not limited to, the purchase and sale of securities, the receipt and crediting of dividends and interest, and the transfer of other assets of the System.

410.03 The Master Custodian is required to have the ability to provide monthly asset statements of the System and monthly Transaction Summaries. In addition, the Master Custodian must be able to provide line access (daily) to the Board, or their designee(s), to the information stated above. The Board is mindful of the advantages of specialized investments including international investments, risk parity, hedge funds, and other alternative investments. The Master Custodian must have the ability, either directly or through a subsidiary or correspondent custodian, to provide full custodial activities for the international investment, risk parity, hedge funds, other alternative investments, derivative instruments, and OTC instruments of the System.

410.04 Securities Lending: The Board is of the belief that a securities lending program will produce additional income for the System without assuming additional risk. Therefore, the Master Custodian shall have the ability to provide a fully secured securities lending program for the System. The Master Custodian shall be required to pledge assets to serve as collateral for this program in the amount of and/or as a percentage of, the securities lent as determined by the Board. The securities lent shall be marked to market daily, and the Master Custodian shall ensure that sufficient collateral (as described above) shall exist to cover securities lent plus accrued income. The securities that are suitable for collateral shall be cash, U.S. Treasury Bills and Notes, Bankers Acceptances and commercial paper. Additional securities may be suitable for collateral if so approved by the Board.

410.05 Proxy Voting: Proxy voting guidelines are set forth in Appendix H.

410.06 Staff has the authority to transfer temporary excess cash balances from the System’s short term investment fund into enhanced cash strategies when
enhanced cash strategies offer a yield advantage of at least 25 basis points over the current yield of the short term investment fund at the System’s custodian bank.

410.07 Based upon the market environment, Staff has the authority to change the cash allocation range in the regular STIF between 0% - 50%, with the remaining cash balance invested in the government STIF. Notification will be sent to the Board on any change.

410.08 The Board or its designee may not enter into any contractual agreement, which requires the waiver of the right to a trial by jury.

410.09 The Board or its designee may not enter into any contractual agreement, which requires binding arbitration.

410.10 The Board or its designee may not enter into contracts or agreements that require the waiver of sovereign immunity.

410.11 The Board or its designee may not enter into contracts or agreements that require the System to indemnify any party.

410.12 The Board or its designee may not enter into contracts or agreements that contain confidentiality provisions that are in violation of the provisions of the Texas Public Information Act or that would provide the appearance of violating the letter of the law, or spirit of the Texas Public Information Act.

410.13 The Board authorizes the Executive Director to execute contracts on the System’s behalf as approved by a majority vote of the Board.

410.14 Distributions in Kind: In order to provide for the efficient liquidation of distributions-in-kind from the System’s investment in limited partnerships, the Executive Director is authorized to execute all necessary documents to establish accounts, execute trade orders, and perform other procedures necessary to liquidate distributions-in-kind with the distributing brokers chosen by the General Partners of the distributing partnership. Such liquidations shall be made as soon as is administratively feasible subsequent to notification of the distribution of such securities.

411.00 INVESTMENT MANAGER REPORTING REQUIREMENTS

411.01 Formal reviews with the Board will be held annually or as otherwise scheduled by the Board. The dates of meetings will be scheduled in advance and notification will be made in writing, either electronically or hard copy.

411.02 Each contract for investment management services with an external manager shall specify the applicable policies, risk controls, portfolio characteristics,
reporting requirements, requirements or restrictions, including criteria for determining quality of investments. Periodic Manager reporting should include the following information:

411.03 Equity

An outline of the current investments and strategy, providing the following:

A. Holdings List

B. List of securities acquired and disposed of during the reporting period

C. Performance Report

D. Performance Attribution

E. Risk Measures

F. Trade Detail

411.04 Fixed Income

A. In addition to listing each asset according to cost, market value and estimated annual income, the fixed-income portfolio should be presented in a format designed to illuminate the relevant aspects of the portfolio and its current strategy. For example, in addition to a simple statement of assets, each report should include:

B. Percentage breakdown of assets within the portfolio by classification, i.e., governments, industrial sector and country and cash equivalents, which are defined as any credit instrument with a maturity within one (1) year from the date of acquisition.

C. A maturity sector analysis for the bond portfolio vs. a market index comparison.

D. Quality analysis for individual securities and for the total portfolio.

E. Average-weighted yield for the portfolio.

411.05 Alternative Investments

A. Pertinent information on investment developments including a summary of any appraisal or valuation results by investment or by property. This data should be provided at least quarterly.
B. Quarterly report of performance of investments.

C. Timely reports on any significant events of investments, properties, companies or businesses in the real estate, real assets, and private equity portfolio.

D. Annual financial statements of each fund or investment, as is applicable, with interim financial statement updates as available.

E. An annual report detailing any litigation or regulatory investigation, review or action.

F. Internal Management
   - Board approved strategies may be implemented by internal Staff and the Board will be kept comprised of these strategies as follows.
   - Performance reported in the daily Flash report
   - Performance and attribution analysis in the monthly Investment Data Handbook.
   - Risk reporting (volatility, leverage, etc.).

G. Private Equity and Real Estate
   - Quarterly or other interim financial statements for each partnership
   - Quarterly analysis of capital account
   - Quarterly performance reports

H. Hedge Funds
   - Quarterly or other interim financial statements for each fund
   - Attribution reports of fund performance.
   - Risk exposure reports for each fund
   - Monthly statements of units and unit values
   - Valuation reports and internal control reports where available

I. Risk Parity
HOUSTON POLICE OFFICERS’ PENSION SYSTEM
INVESTMENT POLICY
Section 400

- A list of risk exposures and capital allocations in addition to details of the components of each risk and capital allocation
- Attribution of returns by each risk exposure
- Portfolio leverage
- Portfolio cash balances and a detail of cash investments

411.06 General (All Managers)

A. A forward look at the economic and market outlook and the portfolio's posture regarding perceived future opportunities.

B. Performance from inception as well as recent 1, 3 and 5-year periods using Global Investment Performance Standards with relative comparisons against market indexes.

C. The Board is to be promptly notified of items of importance which may occur, such as changes in the working relationship with respect to material changes in the organization (departures from the firm of key policy-making personnel, including partners, analysts, portfolio managers and department managers, any changes in the firm's basic investment philosophy or approach) and any recommendations concerning any change in policy which should be considered by the Board.

412.00 POLICY REVIEW AND UPDATE

412.01 When considered necessary, the Board will review the Investment Policy to determine if the long term goals and objectives of the System are still appropriate as stated. A long-term perspective of the System and the capital markets will be maintained. While the Policy may be re-examined for a variety of reasons, the following conditions will be noted as possibly meriting a formal review of Policy:

A. Significant changes in the number of active or retired participants;

B. System changes that result in a liability change affecting future contributions that are expected to exceed plus or minus 10% of the prior years’ cost;

C. Changes in legislation that are applicable to the System;

D. Anticipated changes in the ability of the City of Houston or the System participants in making required contributions.
APPENDIX A - ROLES AND RESPONSIBILITIES OF FIDUCIARIES TO THE SYSTEM

The Board

A. Bears ultimate responsibility for the System and the appropriateness of its investment policy and its execution.

B. Engages Staff, consultants, investment managers, custodian and other advisors to implement and execute investment policy as it relates to the Plan.

C. Reviews adequacy, or need for change, of this Statement.

D. Administers and interprets the governing documents of the System.

E. Defines investment policy and objectives for the System.

Standard of Conduct

The Board and its Staff, as fiduciaries, operate under an extremely high standard of care, and as such must not enter into any action or transaction which would be considered a conflict of interest and/or not in the best interest of the System.

Investment Managers

A. Will have full discretion in the management of those monies of the System allocated to the investment managers, subject to the overall investment guidelines set by the Board and their contractual and fiduciary responsibilities.

B. Serve as fiduciaries responsible for portfolio management and for specific risk and securities decisions.

C. Will abide by duties, responsibilities and guidelines detailed in any specific investment manager agreement.

Master Custodian

A. Accepts possession of securities for safekeeping, collects and disburses income, collects principal of sold, matured or called items, provides periodic accounting statements and processes and maintains securities lending program.
B. Meets as required with the Board and makes reports relative to the status of the System.

C. Acts as fiduciary to the System.

413.05 Investment Consultant/Staff

A. Assists the Board in developing investment policy guidelines, including asset class choices, asset allocation targets, and risk exposures and diversification.

B. Provides the Board with objective information on the broad spectrum of investment strategies, risk control, and investment management specialists and helps construct and implement a risk controlled investment portfolio of both internally and externally managed strategies and to select a portfolio management team of qualified investment managers.

C. Once investment specialists have been selected and the investment strategy has been implemented, monitors the performance of the overall portfolio and the investment managers and provides regular quarterly reports to the Board, which will aid them in carrying out the intent of this Statement.

D. Report findings and recommendations to the Board on a periodic basis. These reports should cover overall performance, volatility, liquidity, transparency, and leverage as well as reports on individual managers and strategies.

E. Evaluates and makes recommendations, as needed, on other areas of investment, such as venture capital and foreign securities.

F. Acts as fiduciary to the System.

413.06 Outside Advisors

A. Pension investment consultant.

B. Consulting actuary.

C. Legal Counsel.

D. Independent Auditor.

E. Any other consultants as required by the Board.
F. Staff

The Outside Advisors listed in A through E above are subject to the terms of contracts between such advisors and the Board.

The Staff under the direction of the Executive Director is responsible for planning, organizing, and administering the operations of the System in accordance with policies established by the Board.
414.00 APPENDIX B - ALTERNATIVE INVESTMENTS

414.01 Alternative investments cover a broad range of non-traditional investments which typically have no public market, are highly illiquid and have potential for significant long-term returns. These investments include but are not limited to the following:

414.02 Venture Capital: Venture capital is an investment, usually in the form of equity participation, in new or developing private businesses.

414.03 Leveraged Buyouts: Leveraged buyout investing provides leveraged capital to restructure, or purchase a significant portion of public or private companies.

414.04 Mezzanine Financing: Investment in the form of subordinated debt with equity conversion potential in privately owned companies.

414.05 Distressed Securities: These in general are debt instruments of companies undergoing financial distress, restructuring or bankruptcy, having a very high current yield.

414.06 Energy: Investments in proven reserves, exploration, and distribution or energy-related investments.

414.07 Timberland: Investments in land stocked with commercially valuable trees.

414.08 Real Estate: Income producing properties or raw land.

414.09 REIT: A Real Estate Investment Trust (REIT) is a closed-end investment company that invests capital obtained through the issuance of stock in various types of real estate.

414.10 Targeted Investments: These are investments targeted to specific geographic areas, economic sectors, or minority-run businesses.

414.11 Managed Futures: Pools of capital used to purchase futures for speculative purposes. Strategies may include indexed futures that can produce returns with and without inflation.

414.12 International Private Equity: Funds invested primarily in private companies outside the United States.

414.13 Hedge Funds: Investment vehicles usually in the form of partnerships which employ non-traditional active management strategies.
414.14 Structured Beta, or Risk Parity strategies can take the form of commingled vehicles, separate accounts, or overlay structures. The strategies diversify risk across various economic environments and risk premiums through a combination of derivatives and cash investments.

414.15 Co-Investments: Direct investments in individual opportunities as offered by alternative investment managers.
APPENDIX C - ASSET REBALANCING

415.01 The Board recognizes that the asset mix of the System will fluctuate from time to time and might occasionally fall outside established targets. As part of the continuing asset management process, the System adopts an asset rebalancing policy which seeks to actively shift capital and risk exposures in order to bring each asset class and risk exposure in line with the target goal. The following guidelines govern the System’s asset rebalancing:

A. Frequency: at a minimum of once per month and/or whenever any asset class falls outside the target range as established by this Policy, the System’s Staff will analyze the entire portfolio to determine whether asset rebalancing is desirable, considering factors such as risk exposures, cash flow requirements and addition or termination of investment managers.

B. Asset rebalancing will be implemented either through the use of derivative instruments, a rebalancing manager, completion portfolio strategies or shifting capital or risk exposures among the major asset classes and investment strategies.

- Unless a waiver is provided by the Board, major asset classes shall be rebalanced when they are over or underweight strategic targets by 2.5 percent subject to liquidity constraints.

C. The Executive Director and Chief Investment Officer shall jointly have the authority to carry out the asset rebalancing and shall report all rebalancing activity to the Board.
APPENDIX D - INVESTMENT MANAGER SELECTION CRITERIA

416.01 Investment manager selection criteria are the screening rules established to identify the management organizations and investment vehicles best suited to meet the needs and objectives of the System. As the investment needs of the System are ever changing, so are the criteria appropriate for the selection of investment managers. Additional criteria and/or amendments to these criteria may be made by the Board when appropriate.

416.02 General Selection Criteria for Investment Managers

A. Manager candidates should have a real-time performance record of five years or more for the specific investment product that the System is seeking. However, recognizing that past performance is not indicative of future results and the fact that attractive opportunities may be available without this target, qualitative exceptions to this rule may be adopted by the Board.

B. Manager candidates must have demonstrated a long-term record of performance superiority.

C. Manager candidates must have registered with the SEC as investment advisors or be exempt from registration.

D. Manager candidates should have a material amount of assets under management for that specific investment product unless a waiver is authorized by the Board.

416.03 Specific Criteria for Specific Investment Managers

The Board will establish specific selection criteria for each investment manager search appropriate for the investment product the System is seeking and such criteria may differ from Section 416.02 above.

The Board should monitor the concentration of investment in any one fund or group in order to maintain a reasonable level of diversification.

416.04 Criteria for Alternative Investment Managers

A. The general partners or sponsors of alternative investment funds must possess the management skill and industry knowledge in order to exercise influence or have an impact on the portfolio companies that the funds invest.
B. The contract terms must not grossly favor the general partners over the limited partners (investors).

C. Capital commitment by the general partners should be significant.

416.05 Minority or Woman Owned Investment Management Firms

A. HPOPS will provide equal business opportunity to all investment management firms without regard to the race, religion, sex, national origin, age, or disability of any firm’s principals, employees, associates, or investors.

B. The Board is committed to encourage the development, growth, and participation of minority or woman owned business enterprises. However, such investment managers must meet the criteria set forth under 417.03 to 417.05.

C. The Board is not obligated to award any contracts to minority or woman owned firms if to do so would, in the Board’s judgment and considering all factors, be imprudent.

D. A minority or woman owned firm shall be defined as a firm whose controlling interest (51% or more) is owned by principals who are citizens or legal resident aliens of the United States and fall into any of the designations listed below:

1. Black, African American (having origins in any of the Black racial groups of Africa).

2. Hispanic/Spanish, a person who is Mexican, Puerto Rican, Portuguese, Cuban, or “other Hispanic/Spanish” in origin or descent. “Other Hispanic/Spanish” are those whose origins are from Spain or the Spanish-speaking countries of Central or South America. Persons of Spanish origin may be of any race.

3. Native American, a person having origin in any of the original peoples of North America (American Indian, Eskimo, Aleut, Native Hawaiian).

4. Asian-Pacific American, a person having origins in the Far East, Philippine, Vietnam, Korea, Samoa, Guam, the U.S. Territories of the Pacific, Northern Marianas, Laos, Cambodia, Taiwan, or the Indian subcontinent.

5. Woman, a person who is a female.
6. Disability, a physical or mental impairment that substantially limits one or more life activities.
APPENDIX E – MANAGER SEARCH PROCEDURE

417.01 All investment manager searches will be conducted according to the process described herein that is approved by the Board.

417.02 Variation from this procedure will occur only as approved by a majority vote of the Board.

417.03 The Investment Staff, and consultant where applicable, will determine the circumstances under which a manager search is appropriate and the timetable for the completion of the search and make such recommendations to the Board for approval.

417.04 The Investment Staff, and consultant where applicable will establish the criteria for the search of potential manager candidates and make such recommendations to the Board for approval.

417.05 The Investment Staff, and consultant where applicable, will provide the Investment Committee with the names of the managers who meet the established criteria. The Investment Staff, and consultant where applicable, will provide the Board with manager search booklets outlining names of managers and giving further pertinent information for each manager candidate.

417.06 The Staff will determine which managers, who meet the established search criteria, will be invited to participate in the Request for Proposal (RFP) or a Request for Information (RFI) phase and a list will be provided to the Board. Any Board member may include additional managers in the RFP / RFI process as long as such additional manager(s) meet the established search criteria.

417.07 If the Investment Staff considers it necessary in the circumstances the HPOPS Staff or Investment Consultant will develop, and disseminate the appropriate RFP or RFI. The Executive Director will contact the Board to inform them that the RFP/RFI is available for their review. The RFP/RFI’s will be distributed to the selected managers only upon the approval of the Board (Investment Committee if so designated). Copies of all the returned RFP/RFI’s will be distributed to the Board.

417.08 Investment Managers that complete and return the RFP/RFI will be graded by Staff and a short list of managers will be selected through this grading process. This short list of managers other than managers for index and enhanced index products will be scheduled for an interview by the Board and Staff in the HPOPS office. Documentation of the RFP and grading process will be available for review by the Board in the System office. It will be the
responsibility of Staff to schedule the meetings and notify the Board of the date and time of the meetings.

417.09 Upon the Staff’s completion of a full review of the managers for index and enhanced index products, Staff will make hiring recommendation(s) to the Investment Committee for final approval by the Board.

417.10 Upon completion of the interviews, the HPOPS Staff will produce and distribute manager search booklets to the Board of Trustees.

417.11 If considered necessary, the Staff, subject to Board approval (Investment Committee if so designated) will establish a list of prospective managers who will be visited by Board members and/or designated Staff. The purpose of the visit to the prospective manager’s place of business is to finalize the due diligence process. After all visitations are completed, the Staff will make recommendations to the Investment Committee which will meet and establish a hiring recommendation for the Board of Trustees.

417.12 The Staff will advise the Investment Consultant, if any, of the Investment Committee’s recommendation and seek their recommendation.

417.13 The Staff will verify performance data of the managers recommended by the Investment Committee.

417.14 A majority vote of the Board is necessary in order to hire a manager. The Board shall consider the recommendation of the Investment Committee, Staff and the Investment Consultant, if any, when deliberating on the appropriate action.
APPENDIX F - COMPLIANCE OF PERFORMANCE PRESENTATION

418.01 The performance of all equity and fixed income managers must be verified by the Staff before they are hired as follows:

A. The manager must comply with the Global Investment Performance Standards (GIPS) and/or

B. The System’s Staff performs a due diligence check on the manager’s return by reviewing the performance record of the investment manager in a public data base and/or by contacting existing clients of the investment manager for confirmation of performance data (the System’s Staff will select several clients randomly from the client list of the investment managers).

418.02 The performance of the individual portfolios under management by the System’s investment managers must be verified by the System’s Staff, investment consultant and custodian bank, as applicable.
419.00  APPENDIX G – ON-SITE DUE DILIGENCE MEETING WITH INVESTMENT MANAGERS (due diligence procedures subsequent to hire)

419.01  Investment Process

A. Review investment team personnel additions and deletions.
B. Review additions and deletions of committees and the personnel on such committees.
C. Review deal and research sources.
D. Review procedures utilized by the manager in the investment process.
E. Review investment performance versus risk, peers and expectations.

419.02  Current Exposures

A. Review significant individual exposures in the portfolio in order to obtain an understanding of the:
   - Investment thesis
   - Risks
   - Exit strategy
   - Fit in overall investment portfolio

419.03  Risk Control

A. Review the risk control environment.
B. Review the risk metrics utilized in managing the investment portfolio.
C. Review compliance procedures utilized in the management of the investment portfolio.

419.04  Portfolio Construction

A. Review the portfolio concentrations.
B. Review the rationale, performance and construction of any hedges.
C. Review the liquidity management.
D. Review the management of downside protection.

419.05  Market Environment

A. Review the investment manager’s views on the current economic and market environment.
B. Review how the portfolio is structured to take these views into effect.
C. Review the universe of investment opportunities.
419.06 Litigation / Conflicts

A. Review pending or potential litigation or sanctions.
B. Review potential conflicts of interest.
C. Update the status of any regulatory reviews.

419.07 Personnel

A. Review changes in the manager’s back-office personnel, consultants and service providers.

419.08 Costs / Expenses

A. Review management’s fee and incentive fee structure.
B. Review the costs charged to the portfolio.
C. Review any of the manager’s other lines of business or sources of income.

419.09 Ownership Structure

A. Review the ownership structure with a view towards:
   • Personnel incentives
   • Alignment of interests
   • Conflicts of interest

419.10 Business Management

A. Review management’s allocation of time between managing the investment process and management of the overall entity.

419.11 Assets Under Management

A. Review changes in assets under management and how they may affect the investment process.
B. Review new products offerings and the termination of product offerings.

419.12 Competition

A. Review the investment manager’s views on current competition for the manager’s investment strategy.
B. Review the managers overall business and how the portfolio is structured to take these views into effect.
420.00 **APPENDIX H - PROXY VOTING**

420.01 The Board believes that proxy votes have an economic value. They must, therefore, be exercised to protect and enhance the long-term value of the System’s assets, and for the exclusive benefit of the beneficiaries and participants.

420.02 Because of the complexity of issues and the direct impact on investment values, it is the Board’s belief that the Investment Managers that are employed by the System are in the best position to vote the proxies of shares held in the portfolios they manage. However, the Investment Managers are required to follow the proxy voting guidelines enumerated below. On matters not covered by these guidelines, the Investment Managers should vote proxies in accordance with their own policies and in the best interest of the System Fund. In general, the Investment Managers should vote for issues which will enhance shareholders’ long-term value and against issues that decrease long-term value.

420.03 Proxy issues can be classified into two broad categories: routine matters and non-routine matters.

420.04 Routine Matters: Routine proxy proposals should be voted in support of management proposals unless there is a clear reason not to do so. Routine matters include:

A. Election of directors.

B. Corporate name change.

C. Appointment of independent auditor.

D. Stock dividend or split.

E. Amendment of Articles of Incorporation that is required to comply with Federal or State regulation.

F. Change in the date, time or location of annual meeting.

420.05 Non-Routine Matters: Each non-routine issue must be carefully analyzed. The following guidelines apply to specific proposals:

A. **Supermajority:** Against

   In general, provisions that provide for more than a majority vote are not in the best interest of the shareholders. A supermajority provision is an anti-takeover measure.
B. Elimination of Poison Pills: Case-by-Case Basis
Poison pills generally consist of “rights” issued to shareholders in the form of preferred stock or warrants to purchase securities exercisable in the event of a hostile takeover bid.

C. Fair Price Provisions: For
Fair price provisions are designed to prevent one particular kind of takeover tactic, the two-tier, front-end-loaded hostile tender offer.

D. Greenmail: Against
Greenmail amounts to blackmailing management by predators who accumulate 10% to 25% of the company’s stock into buying their holdings at a price greater than the fair market value. Greenmail payments to predators are one of the most wasteful uses of corporate assets to the detriment of all other shareholders.

E. Issuing Targeted Share Placements: Case-by-Case Basis
Targeted share placements provisions are used as an antitakeover tool (the “white knight” strategy), where investors of targeted share placements usually receive preferential terms that are not offered to other shareholders, thus reducing shareholder value. Shareholders should be given the right to review and approve any such transactions.

F. Independent Directors: vote for proposal requesting that the board audit, compensation, and nominating committees be composed exclusively of independent directors.

G. Blank Check Preferred: Case-by-Case Basis
Preferred shares give the company the flexibility in financing and acquisitions. However, in some cases they are used to funnel new shares directly to interests allied with management or to issue poison pill rights without first obtaining shareholder approval.

H. Size of Board of Directors: Case-by-Case Basis
Proposals to increase or decrease the size of the board should be examined carefully to determine whether such a change would be detrimental to the long-term shareholder value.

I. Classified Board: Against
All directors should be accountable on an annual basis. A vote against classified board prevents the perpetuation of bad management practices.

J. Confidential Voting: For
Confidential voting is consistent with the democratic practices.
Shareholders (especially employee shareholders) should feel free to vote without pressure or fear of reprisal from management and be able to vote all proxies on the merit of each proposal.

K. **Cumulative Voting:** Against
   A provision for cumulative voting could result in and may encourage members of special interest groups cumulating their vote to elect a director or directors.

L. **Stock Ownership Requirements for Directors:** Against
   Imposing an across-the-board minimum ownership requirement could prevent many highly qualified individuals from serving as directors. However, directors are encouraged to own stocks in the companies they serve.

M. **Preemptive Rights:** Against granting preemptive rights; for elimination of preemptive rights.
   Preemptive rights result in a loss of financing flexibility on the part of the company. Shareholders wishing to protect their ownership interest will have no difficulty maintaining their relative position through open market purchases.

N. **Unequal Voting Rights:** Against
   Unequal voting rights provisions concentrate voting power in the hands of incumbent management and other insider who own substantially less than a majority of the share. In most cases, management is able to perpetuate itself without the support of a majority of shareholders.

O. **Golden Parachutes:** Against
   Golden parachutes are designed to enrich a few senior management people and do not benefit shareholders when there is a change in control.

P. **Tin Parachutes:** For
   Tin parachutes provide change-in-control severance pay for middle management and other regular employees. The payout normally is based on length of service. Tin parachutes are justified in general because they enhance the company’s ability to maintain and improve employee morale.

Q. **Social Issues:** Case-by-Case Basis
   Proxies must be voted for the long-term economic interest of the System. Therefore, any social issues should be evaluated strictly on their long-term economic impact on shareholder value.
R. **Other Issues:**
For issues not specifically enumerated in this Appendix, the Investment Managers will vote on a case-by-case basis taking into account the relevant facts and circumstances. Furthermore, notwithstanding the above, exceptions may be made on a case-by-case basis.

420.06 The investment managers must provide the Board copies of their proxy voting policies. On an annual basis, the investment managers must provide the Board their proxy voting report detailing the shares of securities voted, the issues involved, the votes made and a brief explanation on votes that are not consistent with proxy voting guidelines of the System or investment managers.
APPENDIX I – ALTERNATIVE INVESTMENT OPERATING PROCEDURE

421.01 The consultant for alternative investments (Consultant) will keep the Board and Staff abreast of interesting opportunities that may possibly lead to an investment recommendation. Alternatively, Staff may recommend individual funds to the Board subject to appropriate due diligence by Staff and/or the investment consultant.

421.02 Upon completion of due diligence, Consultant will send its investment recommendation to the Staff together with a copy of the private placement memorandum and other relevant information of the fund to be considered.

421.03 Staff will review Consultant’s recommendation and the private placement memorandum and other relevant information.

421.04 Consultant will discuss the recommendation with the Staff and will attempt to resolve concerns and address issues the Staff may have. The Staff may recommend due diligence phone conference or on-site visit with general partners by the Trustees and/or Staff.

421.05 If Staff is in agreement with Consultant’s recommendation, it will present the recommendation to the Investment Committee. The Staff will keep the Investment Committee informed of any recommendation not acceptable to the Staff along with reasons for Staff’s non-acceptance of the recommendation.

421.06 The Investment Committee will deliberate the recommendation, taking into consideration the following:

B. type of investment;

C. diversification: manager (general partner), industry and geographic location;

D. size of committed capital;

E. total amount invested by the System in alternative investments;

F. cash flows of the System; and

G. how it fits in with the overall investment strategy.

421.07 Consultant will be available to discuss issues and concerns with the Board on a direct basis.
The Investment Committee may recommend a due diligence visit with the general partners by the Board and/or Staff. The Investment Committee will make its recommendation to the Board.

The Board will vote to approve or disapprove the investment recommendation made by the Investment Committee.

If an investment recommendation is approved, Consultant will work with the Staff to complete the steps (such as negotiating partnership terms and conditions, and review of legal documentation) necessary to effect the closing of the investment.

Subject to any future changes in the IRS Code when investing in alternative assets, the System will avoid blocker corporations or similar constructs that seek to shield HPOPS from UBTI.

When investing in hedge funds, the System will opt out of any illiquid private equity-type allocations by individual managers.
APPENDIX J – INVESTMENT VALUATION POLICY

Objectives

422.01 Establish a Valuation Framework - Establish a framework to consistently measure the fair value of the System’s assets and liabilities in accordance with applicable accounting, legal, and regulatory guidance. This framework should be provided by establishing valuation policy and procedures that will provide reasonable assurance that assets and liabilities are carried at fair value as described above.

422.02 Compliance with Applicable Accounting, Legal, and Regulatory Guidance - This Policy seeks to have all assets and liabilities reported at fair value on a consistent, transparent and prudent basis. Fair value as defined in accordance with GAAP is “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date” (Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC of Codification), ASC 820, Fair Value Measurements). The objective is to estimate the exchange price at which hypothetical willing marketplace participants would agree to transact in the principal market, or lacking a principal market, the most advantageous market. No matter which market is deemed most appropriate, fair value is the estimated “exit price” in that market.

422.03 Establish Management’s Responsibility – Management (Trustees and Staff) is responsible for making the fair value measurements and disclosures included in the System’s financial statements. As part of fulfilling its responsibility, Management needs to establish an accounting and financial reporting process for determining the fair value measurements and disclosures, select appropriate valuation methods, identify and adequately support any significant assumptions used, prepare the valuation, and ensure that the presentation and disclosure in the System’s financial statements of the fair value measurements are in accordance with GAAP.

This responsibility cannot, under any circumstances, be outsourced or assigned to a party outside of Management. Although Management may look to the investment manager for the mechanics of the valuation, Management must have sufficient information to evaluate and independently challenge the investment manager’s valuation. The underlying investments generally are measured at estimated fair value by the investment manager in accordance with its stated valuation policies for determining net asset value.

422.04 Scope of Valuation Procedures - In the absence of availability of a detailed listing of the underlying investments as of the System’s year-end, the System
may gain sufficient understanding of an underlying fund through other activities. These activities could include, but not be limited to, periodic interviews with fund management to understand the fund’s strategy, positions, and valuation methodologies sufficient to provide the System with the ability to compare the data obtained from the fund manager with other available information, such as sector data, indexes, and cash distributions. Such data could be further corroborated with information regarding the underlying investments obtained through the annual audited financial statements of the alternative investment.

The extent of the process utilized by the System and the related controls should reflect the significance of the alternative investments to the System’s financial statements, the nature of the underlying investments, and management’s risk assessment.

Management’s valuation process need not include recalculation of estimated fair values for alternative investments, but it should ensure that the System has a sufficient understanding of the characteristics of the underlying investments and the alternative investment’s valuation process for investments held as of the System’s balance sheet date. As such, the System need not prepare a separate valuation of the underlying investments unless it becomes aware that valuation methodology or assumptions used by the fund manager are incorrect, incomplete, or otherwise unsatisfactory. Although obtaining the detail of the underlying investments may indicate a strong process, simply obtaining the detail is not sufficient by itself for management to support its assertion regarding the valuation of the alternative investments.

422.05 General Valuation Guidelines

422.06 The structure of the System’s various investment portfolios is as follows.

- Separate Account Assets
- Bank Commingled or Collective Funds
- Limited Partnership Interests
- Offshore Mutual Funds

The following sections provide an outline of the types of investment vehicles/strategies in which the System is invested as well as a set of specific policy guidelines for each.

Please see the accompanying sections that provide a detail of the characteristics and ASC 820 classification of current System assets and liabilities.

422.07 Separate Account Assets - Separate Account Assets can consist of equity, fixed income, and derivative securities that can be traded on an exchange,
over-the-counter, or in private transactions. In a separate account structure the Investment Manager determines fair value for each asset and liability in accordance with their internal valuation procedures, and then either agrees with or challenges the fair value produced by the custodian. The fair value of each security is determined by both the investment manager and the custodian by using Level I, Level II or Level III prices, as appropriate, on the calculation date, pursuant to the valuation policy of the manager or custodian.

The portfolio securities of long-only equity managers are all Level I assets, as these securities are valued based on quoted prices in active markets with sufficient frequency and volume to provide pricing information on an ongoing basis. HPOPS’ policy for separate accounts is then as follows.

- Maintain and document an understanding of the custodian’s valuation process and evaluate the reasonableness of such policy.
- Maintain and document an understanding of the valuation process of the underlying investment managers and evaluate the reasonableness of such policy.
- Implement a program to review and evaluate the reconciliation process between the fair value estimates provided by the custodian and the Investment Manager.
- Implement a program of additional procedures as considered necessary to address any weaknesses in either the custodian or Investment Manager’s valuation policy.
- Implement a program of additional procedures as considered necessary to address any HPOPS-specific liquidity, marketability, legal, regulatory, or other restrictions that may require the assessment of a discount or premium to the fair value of each asset or liability.

**Bank Commingled or Collective Funds** - Bank Commingled Funds or Collective Funds, are funds that are a trust, which is an entity separate from the bank / custodian, other Collective Funds, and the investing participants. A Collective Fund is established under a “Plan” that sets forth the terms under which the bank manages and administers the Fund’s assets. The Plan documents may be amended from time to time.

The bank is trustee of each individual Collective Fund trust, and holds legal title to each trust’s assets for the exclusive benefit of the trust’s beneficial owners. Clients of the bank who invest in a Collective Fund trust are the trust’s beneficial owners. Each beneficial owner owns an undivided interest in the
trust’s assets; no participant directly owns any asset of the trust. Participants’
interests are represented by accounting entries in the trust records.

The bank tracks participants’ interests in Collective Funds through notional
“units.” A Fund may issue an unlimited number of units, and units have no
preferences as to conversion, transfer, dividend or redemption. However,
Collective Funds can issue different classes of units. Generally, participants
have no voting or management rights, and there are no unit holder meetings
or other meetings of participants. Units are not transferable, but they may be
redeemed. Funds have no boards and therefore no directors or officers. The
bank, as trustee, has exclusive authority over management of the Funds. In
this fund arrangement, a client enters into an investment management
agreement with the bank. The bank also enters into an agency agreement with
the client’s trustee or custodian pursuant to which the bank takes custody of
the client’s assets. The bank then contributes the assets to the group trust.

The unit value of a collective investment is calculated by dividing the fund’s
net asset value on the calculation date by the number of units of the fund that
are outstanding on the calculation date. The fund’s net asset value is calculated
by using Level I, Level II or Level III prices, as appropriate, to value each
security and/or other asset held by the fund on the calculation date, pursuant
to the fund’s valuation policy. In short, the net asset value of a collective
investment fund is calculated based on a compilation of primarily observable
market information. The number of units of the fund that are outstanding on
the calculation date is derived from observable purchase and redemption
activity in the fund. Accordingly, pursuant to ASC 820, the unit value for a
collective investment fund is considered to be a Level II price.

422.09 HPOPS’ policy for bank commingled or collective funds is as follows.

- Maintain and document an understanding of the fund’s valuation
  process and evaluate the reasonableness of such policy.

- Implement a program to perform additional procedures as considered
  necessary to address any weaknesses in fund’s valuation policy.

- Implement a program to perform additional procedures as considered
  necessary to address any HPOPS-specific liquidity, marketability,
  legal, regulatory, or other restrictions that may require the assessment
  of a discount or premium to the fair value of each asset or liability.

- Implement a program to periodically monitor, test, and update our
  understanding of the valuation policy and procedures of our custodian
  and of the underlying investment managers.
422.10 Limited Partnership Interests - The System may purchase limited partnership interests in certain “funds” wherein the General Partner of the fund may purchase on behalf of the fund certain equity and debt securities of private companies.

Securities of private companies, by definition, will not have quoted market prices available. However, private companies at times engage in arm’s-length transactions for issuances of their equity or debt securities. The value of these transactions could serve as an observable market price similar to a quoted market price if the transaction is both recent and between willing parties for the same securities as those for which the fair value determination is being made (deemed a level 2 input by ASC 820) and could therefore be used as an estimate of the theoretical exit price.

When quoted market prices or arm’s-length transaction prices as described above are not available, the estimate of fair value should incorporate all reasonably available information about the underlying investment and utilize assumptions that market participants would normally use in their estimates of value. The estimate of fair value should seek to best replicate the amount at which the investment could be sold in a current transaction between willing parties. In a fair value determination for an investment, there may be multiple valuation techniques employed and various levels of inputs. The lowest level of significant input determines where in the fair value hierarchy the investment is placed. There are enhanced disclosures required for Level 3 investments as these represent the investments for which the greatest amount of judgment and estimation have been applied. An evaluation is performed of the inputs used in the fair value determinations. Generally, it is expected that a significant portion of the investments in limited partnership interests by the System would require classification as Level 3 assets.

422.11 HPOPS’ policy for bank commingled or limited partnerships is as follows.

- Maintain and document an understanding of the partnership’s valuation process and evaluate the reasonableness of such policy.
- Implement a program to perform additional procedures as considered necessary to address any weaknesses in limited partnership’s valuation policy.
- Implement a program to perform additional procedures as considered necessary to address any HPOPS-specific liquidity, marketability, legal, regulatory, or other restrictions that may require the assessment of a discount or premium to the fair value of the System’s interest in the partnership.
• Implement a program to periodically monitor, test, and update our understanding of the valuation policy and procedures of the partnerships

• To the extent possible, obtain FAS 157 compliant audited financial statements from the partnerships and develop a procedure to roll-forward and review the valuations inherent in these financial statements.

422.12 Offshore Mutual Funds - HPOPS invests in various open-ended mutual funds that are incorporated offshore as exempted companies with limited liability. These funds offer monthly liquidity, are priced monthly at Net Asset Value (NAV), investors hold an interest in units/ shares of the fund representing an undivided interest in the underlying fund assets, and purchases and liquidations of units is at NAV. These funds usually fall within the definition of a "mutual fund" in these tax haven countries, and accordingly are often regulated in terms of mutual fund laws. However, funds are not required to be licensed or to employ a licensed mutual fund administrator due to the relatively high minimum contribution requirement. Liquidity is typically limited to quarterly openings, generally after an initial lockup period.

The Fund delegates responsibility for the management of the Fund’s investments to an Investment Adviser. The Fund delegates certain administrative duties to a third-party administrator and also appoints a custodian for the Fund’s assets. The Administrator’s duties may include maintaining a register of unit/ shareholders, calculating NAV, certain accounting functions, and other administrative services. The custodian provides safekeeping of the Fund’s assets, transaction settlement, income collection, and may also provide a calculation of NAV.

Hedge Fund investments utilizing this structure generally use a prime broker, sometimes referred to as the Administrator. A prime broker serves as custodian of the fund’s securities and performs clearance and settlement of the fund’s transactions in securities and other interests, acts as a registrar of shares, and determines NAV. A prime broker may also provide financing of transactions and securities loans. The NAV is often determined with the involvement of the Investment Adviser.

The unit value of a mutual fund investment is calculated by dividing the fund’s net asset value on the calculation date by the number of shares/ units of the fund that are outstanding on the calculation date. The fund’s net asset value is calculated by using Level I, Level II or Level III prices, as appropriate, to value each security and/or other asset held by the fund on the calculation date, pursuant to the fund’s valuation policy. In short, the net asset value of a mutual fund is calculated based on a compilation of primarily observable market information. The number of share/ units of the fund that
are outstanding on the calculation date is derived from observable purchase and redemption activity in the fund. Accordingly, pursuant to ASC 820, the unit value for a collective investment fund is considered by HPOPS to be a Level II price.

422.13 HPOPS’ policy for offshore mutual funds is as follows.

- Maintain and document an understanding of the fund’s / administrator’s / custodian’s valuation process, as is applicable, and evaluate the reasonableness of such policy(s).
- Implement a program to perform additional procedures as considered necessary to address any weaknesses in the valuation policy(s).
- Implement a program to perform additional procedures as considered necessary to address any HPOPS-specific liquidity, marketability, legal, regulatory, or other restrictions that may require the assessment of a discount or premium to the fair value of the System’s interest in the fund.
- Implement a program to periodically monitor, test, and update our understanding of the valuation policy(s) and procedures of investment managers, administrators, and custodians.
- To the extent possible, obtain ASC 820 compliant audited financial statements from the funds and develop a procedure to review the valuations inherent in these financial statements.