Department of Materials Management
Division of Procurement
MONTGOMERY COUNTY PUBLIC SCHOOLS
45 West Gude Drive, Suite 3100
Rockville, MD 20850

June 28, 2013

ERRATUM #2

RFP #4342.1, 4342.1, MCPS Retirement System Trust RFP
For Investment Consultant Services

Please note the following changes to above-mentioned RFP.

Replace Attach C Investment Policy Statement restated June 2012 with the NEW Attach C Investment Policy Statement restated June 2013.

All other terms and conditions remain the same.

Barbara Regalia

Barbara Regalia, CPPB, Senior Buyer
Division of Procurement

BR

Please indicate your acceptance of this notice by signing below and return with your bid or under separate cover.

Accepted:______________________________
Name and Title

Name of Company:______________________________

Statement of Investment Policy for

Montgomery County Public Schools

Employees' Retirement and Pension System

(Restated June 2013)

I. PURPOSE

Montgomery County Public Schools provides a defined benefit retirement plan ("the Plan") for its employees. The Board of Investment Trustees ("the Board") recognizes its fiduciary responsibility to invest Plan assets prudently and solely in the interest of plan participants and their beneficiaries.

The purpose of this Statement of Investment Policy is to:

- Guide the Board in prudently and effectively supervising, monitoring, and evaluating the investment activities of the Plan,
- Set investment objectives and establish performance criteria against which overall Plan results can be evaluated,
- Define delegation authority to its professional staff in order to implement its investment activities.

This Statement of Investment Policy will be reviewed annually and all changes will be approved by the Board.

The Board recognizes that a portion of Plan assets are invested in both Aetna's General Account and Annuity Separate accounts in order to provide benefit guarantees for plan participants who retired prior to December 31st, 1992. The Statement of Investment Policy governs the Plan and all of its assets and specifically details the risk, return and asset allocation framework of the assets outside of both Aetna's General Account and Annuity Separate accounts.

The Board believes that external management of Plan assets optimizes the potential to maximize risk-adjusted returns and minimize the associated expenses. The Board may direct its professional staff to invest Plan assets in separately managed accounts or in any type of pooled investment vehicle. The deployment of assets in an external manager will be made on a case-by-case basis after reviewing the investment manager structure and style in conjunction with its professional staff and advisors.

II. STATEMENT OF OBJECTIVES

The Board recognizes that its two-fold mandate is to prudently manage the Plan assets such that (i) it has the ability to pay all benefits when due and (ii) it can maximize the investment return utilizing reasonable levels of risk in order to meet or exceed the targeted 7.5% actuarial rate of return. Notwithstanding the potential for short-term negative variances to the Plan actuarial earnings assumptions, the Board is focused on meeting its objectives by maintaining a bias towards long-term performance through multiple economic cycles, including both capital-appreciation and income generation. In order to mitigate potential consequences from volatility in the capital markets, the Board is focused on reducing its risk through its asset allocation decisions, including investment in non-correlated asset categories, and by minimizing the costs incurred in managing the Plan.

III. ASSET ALLOCATION

The Board recognizes that the most significant decision affecting the Plan's ability to meet its stated investment objectives is the asset allocation decision. The Board commissioned an Asset-Liability Study in 2013 to evaluate the long term performance of various asset categories in the context of the Plan's benefit structure, funded status and risk tolerance. After reviewing the Asset-Liability Study in consultation with its professional staff and advisors, the following guidelines are established for the allocation of Plan assets:

Asset Class	Long Term Target	Range
Investment Grade Fixed Income	25%	21% - 29%
Global Equity	50%	46% - 54%
Alternatives Portfolio	25%	21% - 31%
Total	**100%**	--

Asset Class	Beta Portfolio Target	Beta Portfolio Range
Investment Grade Fixed Income	33%	28% - 38%
Global Equity	67%	57% - 72%
Beta Substitutes	<15%	0 – 15%
Total	**100%**	--

The investment policy tables above detail a Long Term Target as well as a Beta Portfolio Target; during any period the Alternatives Portfolio falls outside its policy target and is unable to be reallocated due to liquidity constraints, the Beta Portfolio target will take precedence. However, the primary goal will be to maintain as close to a 25% allocation to Investment Grade Fixed Income as possible and use Global Equity to allow for an overweight to the Alternatives Portfolio. The portfolio is to be reallocated to its policy target at the earliest time liquidity is available in the Alternatives Portfolio but not to the detriment of maintaining the value of these investments.

The asset allocation represents a long term perspective. As such, market shifts or changes in economic conditions may cause the asset mix to fall outside the policy allocation percentage. These divergences should be of a short-term nature, and reallocations should be done in a prudent manner, taking into account all market conditions.

Based on such factors as investment strategy, cash flow, timing of contributions and benefit payments, the Board will determine and manage an appropriate allocation to cash equivalents or other liquid investments that is appropriate to meet the Plan's liquidity requirements in the near term. Liquidity requirements and investments will be reviewed regularly.

The Board will review and revise the asset allocation guidelines from time to time based on analysis of the Plan's liability structure and expected market conditions over the upcoming five to ten year time horizon. The asset allocation guidelines will be designated in writing and will include acceptable ranges as well as long-term targets.

IV. INVESTMENT POLICY GUIDELINES

1. Investment Grade Fixed Income

The objective of the Investment Grade Fixed Income portion of Plan assets is to provide low-risk exposure and downside protection. The Investment Grade Fixed Income portfolio consists of investment grade, dollar-denominated issues. It shall be invested primarily in passively-managed investment strategies to track the return of the Barclays Intermediate Aggregate Bond Index.

This portion of Plan assets will also include an actively managed investment portfolio that is related to the Aetna annuity contract currently in place to provide benefit guarantees for retirees prior to December 31st, 1992. The amount of assets actively managed will be related to the minimum needed to be maintained according to the Aetna annuity contract.

2. Global Equity

The objective of the Global Equity portion of Plan assets is to provide exposure to economic growth and capture the equity risk premium. The Global Equity portfolio consists of global stocks and shall be invested primarily in passively managed investment strategies to track the return of the MSCI All Country World Investable Market Index.

3. Beta Substitutes

Based on the Asset Allocation in Section III, the Beta Portfolio is designed to expose Plan assets to the relative return and risk profile of Investment Grade Fixed Income and Global Equity.

Subject to the Asset Allocation limitations set forth in Section III, the Board may allocate a portion of the Plan's assets to substitute investment strategies that offer a combination of the low-risk characteristics of Investment Grade Fixed Income and the exposure to global economic growth of Global Equity (often referred to as risk parity strategies). These strategies allocate to asset classes based primarily on risk and seek to balance the risk such that the strategy is positioned to perform well in different economic cycles (e.g. low inflation, high inflation, low growth, high growth). The intent of these Beta Substitutes is to achieve beta exposures with lower total Plan risk and volatility when compared to the assumed risk and volatility of the underlying benchmarks. Beta Substitutes are designed to produce a higher return potential per unit of risk. Beta Substitutes cannot exceed 15% of total Plan assets. This allocation will be funded pro-rata from the Investment Grade Fixed Income and Global Equity asset classes (when comparing actual allocations vs. policy allocations, the Plan will assume a pro-rata share from Beta Substitutes is applied to Investment Grade Fixed Income and Global Equity so there will not be a change to the overall positioning of the Plan's policy allocation when funding this strategy).

4. **Alternatives Portfolio**

The objective of the Alternatives Portfolio portion of the Plan assets is to provide superior risk-adjusted returns, exhibit low correlation, or both relative to the Beta Portfolio. The purpose of the Alternatives Portfolio is also to facilitate investments in shorter-term, opportunistic investment ideas. The Alternatives Portfolio may be comprised of private equity, real estate, hedge funds, absolute return strategies, infrastructure, commodities, TIPS, credit, risk parity (risk parity can be included in Alternatives Portfolio or considered a Beta Substitute as defined previously) or traditional investment strategies.

5. **Other Investments**

The Board may, after consideration of pertinent investment risk and reward attributes, and liquidity, cost and administrative complexity, authorize any investment except as otherwise expressly prohibited.

6. **Derivatives**

Derivative instruments such as futures, options, swaps, and forwards, may be used by the plan's chosen investment managers to implement investment strategies in a low cost, efficient manner or construct portfolios with risk and return characteristics that cannot be created with cash market securities. Derivatives may also be used within the context of a cash overlay program. The main purpose of the cash overlay program is to achieve market exposure consistent with the Plan's Beta Portfolio (Global Equity and Investment Grade Fixed Income) for the amount of un-invested cash that exists on a daily basis. The cash overlay program, administered by an outside investment manager, may buy, sell, and hold exchanged-traded derivative instruments and exchange-traded funds (ETFs).

7. **Leverage**

Leverage is implicit in many investment strategies and leverage in and of itself is not strictly prohibited so long as activities do not materially increase the risk level of the Plan. Leverage will be considered when making manager hire decisions and the Board, in conjunction with its advisors and professional staff, will avoid managers with unreasonable levels of leverage. In addition, both gross and net notional exposures for individual managers will be monitored on a regular basis appropriate to the leverage used by individual managers.

8. **Prohibited Investments**

Montgomery County statutes prohibit investment in Montgomery County and County-related bonds. County statutes also require that real estate investments be made in pooled vehicles in which no more than 10 percent of the pool is invested in real estate located in Montgomery County.

V. REBALANCING

The Board intends to maintain the Investment Grade Fixed Income and Global Equity allocations within four percentage points of the targets, while allowing for a six percent overweight and a four percent underweight allocation to the Alternatives Portfolio due to its reduced liquidity. When any of the allocations falls outside of the upper range, net contributions or asset transfers will be used to bring the allocation back to the mid-point between the Long Term Target and the upper end of the allowed range (see Section III – Asset Allocation); and when any of the allocations falls outside of the lower range, net contributions or asset transfers will be used to bring the allocation back to the mid-point between the Long Term Target and the lower end of the allowed range. During any period the alternatives investment asset class falls outside its policy target and is unable to be reallocated due to liquidity constraints, the marketable securities target will take precedence and will be used to allocate Investment Grade Fixed Income and Global Equity appropriately. However, the primary goal will be to maintain as close to a 25% allocation to Investment Grade Fixed Income as possible and use Global Equity to allow for an overweight to the Alternatives Portfolio.

The Plan will assess the need to rebalanced no less often than on a monthly basis. The rebalancing program may be implemented through the use of the cash overlay program.

VI. DELEGATION TO PROFESSIONAL STAFF

The Board's responsibilities and duties are defined by law. In order to optimize the Plan's objectives, the Board may appoint a person or persons to serve as staff to the Board. The professional staff will be responsible to help the Board implement, monitor and manage the Plan. The professional staff will help the Board interface with its external investment managers, its consultants and its custodian, the roles of which are contractually defined, to help the Board implement its policies. The Board shall direct the staff to perform specific duties to help maximize the Plan's objectives.

VII. PROXY VOTING

Proxy voting rights are an asset of the Plan. The Board recognizes the responsibilities to ensure those rights are exercised in the best interest of Plan participants and their beneficiaries to the extent they are available. The proxy voting decision is usually secondary to the decision to own a security for investment purposes.

The Board will review and consider proxy voting guidelines specified in investment management contracts consistent with the best interests of Plan participants and beneficiaries. When feasible, investment management contracts should require the investment manager to report votes annually to the Board. In the event of any conflict of interest or potential conflict of interest with respect to any proxy vote, the investment manager should be required to notify the Board and the Board shall vote or appoint a third party to vote the proxy.

The Plan may from time to time hold investments in commingled or mutual funds (Funds). The Plan may periodically receive proxies from these Funds which allow the Plan to vote on various issues including but not limited to election of directors or Board, investment policies, fees, Fund structure, Fund liquidation or termination. All such proxies shall be reviewed by the Board, its Chairman or a MCPS staff member to whom responsibility for review has been delegated. In addition, the Board may retain a consultant or outside proxy voting service to make recommendations regarding the voting of these proxies.

Either the Board or the Chairman may determine how, and if, the proxy will be voted based on analysis of recommendations from its consultant, outside proxy voting services or MCPS staff member. All proxy votes by the Chairman will be reported to the Board at its next regularly scheduled meeting.

Proxies will be voted by the Board or the Chairman taking into consideration the financial interests of the Plan and in a manner which maximizes the value of the Plan's investment in the Fund. It is expected that in most cases proxies will be voted in support of the Fund's management regarding routine business, except where doing so would negatively impact the long-term value of the Plan's investment in the Fund. Non-routine matters will require more consideration and review of all relevant facts and circumstances. Matters relating to social, human rights, environmental and similar matters will be considered in the context of whether they have a demonstrable positive economic impact on the Plan's investment in the Fund.

VIII. <u>EVALUATION AND REVIEW</u>

The objective of the evaluation and review process is to monitor the progress of the Plan assets in achieving the overall investment objectives. Particular attention will be directed toward determining whether:

- The total fund is achieving its stated objectives;
- Investment managers are performing satisfactorily in relation to the objectives set forth in this Statement;
- Investment managers are adhering to the guidelines set forth herein and in any applicable investment management agreement;
- Investment managers are adhering to their stated mandate; and

- The overall policies and objectives continue to be appropriate, reasonable, and achievable.

The investment results will be formally reviewed quarterly or more frequently if circumstances warrant, in a written report prepared and presented by the Consultant. Investment results will be evaluated over various time periods recognizing the longer term nature of the Plan's objectives.

IX. PERFORMANCE STANDARDS

1. Total Plan

The objective of the Plan is to match or exceed the return of the Policy Benchmark. The Policy Benchmark is comprised of 25% Barclays Intermediate Aggregate Bond Index, 50% MSCI All Country World Index, and 25% of the Alternatives Portfolio Benchmark (a mix of 33% Barclays Intermediate Aggregate Bond Index and 67% MSCI All Country World Investable Market Index).

The investment objective of the Plan will also be to meet or exceed its actuarial assumption of 7.5% over the long-term investment cycle as well as perform in line or superior to its Policy Benchmark. It will be the objective to the Plan to meet these return objectives while experiencing a level of risk commensurate to its Policy Benchmark.

2. Investment Grade Fixed Income

The objective of Investment Grade Fixed Income is to track the return of its primary benchmark with a low tracking error (the standard deviation of the difference between the returns of an investment portfolio and the underlying benchmark), the Barclays Intermediate Aggregate Bond Index.

3. Global Equity

The objective of Global Equity is to track the return of its primary benchmark with a low tracking error to the MSCI All Country World Investable Market Index.

4. Beta Substitutes

The objective Beta Substitutes is to track the Beta Portfolio Target mix of Investment Grade Fixed Income and Global Equity relative to their respective benchmarks (a mix of 33% Barclays Intermediate Aggregate Bond Index and 67% MSCI All Country World Investable Market Index).

As a secondary benchmark Beta Substitutes will be evaluated against an absolute return benchmark of 90-day T-Bills plus 5%.

5. **Alternatives Portfolio**

The objective of the Alternatives Portfolio is to match or exceed the return of its primary and secondary benchmarks. The Alternatives Portfolio benchmarks will be constructed in a manner that will allow the Board to evaluate the portfolio from multiple perspectives as described below. Below are the primary and secondary benchmarks for the Alternatives Portfolio.

The portfolio's primary benchmark will be comprised of a mix between the Investment Grade Fixed Income and Global Equity benchmarks based on the current investment policy's Beta Portfolio Target allocation (a mix of 33% Barclays Intermediate Aggregate Bond Index and 67% MSCI All Country World Investable Market Index). This benchmark will allow the Board to evaluate the benefit of investing in the Alternatives Portfolio versus how the remainder of the Plan is invested.

As a secondary benchmark the portfolio will be evaluated against a weighted average of the underlying portfolio benchmarks. This will allow the Board to evaluate the success of the underlying managers relative to their stated benchmarks.

As a tertiary benchmark, the portfolio will be evaluated against the actuarial rate of return of 7.5%. This will allow the Board to evaluate the Alternatives Portfolio's contribution to meeting the actuarial assumed rate of return over time, and should be seen as a long-term investment objective which should be achieved over a full economic cycle.

6. **Alternatives Portfolio: Sub-Asset Classes**

The Alternatives Portfolio will consist of sub-asset classes. The investment objectives for these sub-asset classes are listed below.

- **Real Estate** - The return on the total real estate allocation is expected to meet or exceed a blend of the NCREIF ODCE (Open End Diversified Core Equity) Index and the NCREIF Property Index. This blend will be determined based on the overall composition of the real estate portfolio between core and non-core investments.

- **Private Equity** - The return on the total private equity allocation is expected to meet or exceed the Russell 3000 Index plus a 300 basis point premium net of fees with a one quarter lag.

- **Hedge Funds** - The return on the total hedge fund allocation is expected to meet or exceed the HFRI Fund of Funds Composite Index.

- **Commodities** – The return on the allocation to commodities is expected to meet or exceed the Dow Jones-UBS Commodity Index.

- **Bank Loans** – The return on the allocation to bank loans is expected to meet or exceed the S&P Leveraged Loan Index.