GOVERNMENT OF PUERTO RICO

Puerto Rico Fiscal Agency and Financial Advisory Authority

INVESTMENT POLICY GUIDELINES

February 8, 2019

Contents

I. Scope and Purpose

These Investment Policy Guidelines ("Investment Policy Guidelines") govern the investments associated with subdivisions and component units of the Commonwealth of Puerto Rico ("Commonwealth"). The purpose for establishing these Investment Policy Guidelines is for the Fiscal Agency and Financial Advisory Authority ("AAFAF" by its acronym in Spanish) to provide policy making principles for the preparation of Investment Policy Statements ("IPS") specific for each component unit and/or investment activities associated with subdivisions and component units of the Commonwealth, to which these guidelines are applicable ("Investment Program"). An IPS is a written planning document that describes investment objectives and risk tolerance over a relevant time horizon, along with constraints that apply to each Investment Program.

These Investment Policy Guidelines are also intended to anticipate issues related to:

a. Governance of Investment Programs
b. Planning for appropriate asset allocation
c. Risk management
d. Monitoring results
e. Appropriate reporting
f. Implementing Investment Programs with internal and/or external managers

These Investment Policy Guidelines apply to entities that engage in treasury operations, Investment Programs, or any purchase of capital market investments through any broker-dealer. These Investment Policy Guidelines shall apply to portfolios established for:

a. Component Units of the Commonwealth
b. Public Corporations
c. Public Insurance Companies
d. Defined Benefit Retirement Plans
e. Defined Contribution Retirement Plans
f. Municipalities
g. Endowments

These Investment Policy Guidelines do not apply to debt service reserve funds, or to entities that only hold depositary bank accounts, certificates of deposits or money market funds.

According to applicable legal and regulatory framework discussed herein, AAFAF's Executive Director ("Executive Director") or its designee, reserves the right to grant total or partial exemption from compliance with these Investment Policy Guidelines. Exemptions can be granted by AAFAF *motu propio* or upon request by an entity. The factors to be considered to grant exemptions include, but are not limited to:

a. Existence of sound investment controls and resources in the entity, internal or external.
b. Activities performed by the entity and future strategic plans that may render these Investment Policy Guidelines irrelevant.
c. Operational or financial constraints.

AAFAF may, from time to time, request information from entities, which were granted exemption regarding its investment practices. AAFAF may, at any time, revoke the exemption without need to show cause.

A. Statutory Framework

Act 113- 1995, as amended ("Act 113"), authorized the Governor of Puerto Rico, or his authorized agent, to periodically promulgate guidelines and provide advisory services on the investment of public funds to the Commonwealth and to all the agencies, municipalities, public corporations and other public dependencies or political subdivisions of the Commonwealth. The Governor of Puerto Rico delegated this function to the Government Development Bank for Puerto Rico ("GDB") as authorized under the statute. Pursuant to Act 2-2017 ("Act 2"), AAFAF replaced the GDB in this role. Act 113 also exempts the promulgation of investment policy guidelines from the application of the Puerto Rico Uniform Procedures Act.

In accordance with Act 2, AAFAF, in its role as financial advisor and fiscal agent of the Commonwealth, is responsible for the creation, approval, and periodic revision of the Investment Policy Guidelines. Consequently, the Executive Director, or his or her designated personnel, shall prepare, disseminate, and revise these guidelines. The Investment Policy Guidelines should be revised at least every five (5) years, but will remain valid until a new or revised one is approved. Nonetheless, AAFAF may revise or amend these Investment Policy Guidelines from time to time should any change in circumstances affect its implementation.

The Executive Director, or his or her designated personnel, is also responsible for the approval of the IPS to be adopted for each Investment Program, or any amendment thereof, by any Component Unit of the Commonwealth. Supervisory and audit procedures should be set in order to ensure compliance with the Investment Policy Guidelines. To comply, AAFAF will also require that component units report the performance and financial condition for Investment Programs at a given frequency (monthly, quarterly, etc.).

B. Prudence

All participants in the investment process must seek to act responsibly as custodians of the public trust. Overall, Investment Programs must be designed and managed with integrity, competence and diligence.

Participants involved in the management of any Investment Program subject to these guidelines have a duty to conform to the Prudent Investor Rule as general standard.

As general guideline, this rule encompasses the following principles:

The participant involved in the management is under a duty to the beneficiaries to invest and manage the funds as a prudent investor would, in light of the purposes, terms, distribution requirements, and other circumstances of the trust.

a. This standard requires the exercise of reasonable care, skill, and caution, and is to be applied to investments not in isolation but in the context of the portfolio and as a part of an overall investment strategy, which should incorporate risk and return objectives reasonably suitable to the trust.

b. In making and implementing investment decisions, the trustee has a duty to diversify the investments of the trust unless, under the circumstances, it is prudent not to do so.

c. In addition, the trustee must:

    1. Conform to fundamental fiduciary duties of loyalty and impartiality;
    2. Act with prudence in deciding whether and how to delegate authority and in the selection and supervision of agents; and
    3. Incur only costs that are reasonable in amount and appropriate to the investment responsibilities of the trusteeship.

C. Ethics and Conflicts of Interest

The Directors, Investment Committee Members, Investment Officer(s) and any other parties involved in the investment process must:

a. Refrain from personal business activity that could conflict with proper execution of the Investment Program, or which could impair their ability to make impartial investment decisions;
b. Disclose in a timely manner any material financial interests in financial institutions or service providers that conduct business with the Investment Program, and any large personal financial/investment positions that could be related to the performance of the portfolio; and
c. Subordinate their personal investment transactions to those of the Investment Program, particularly with regards to the timing of purchases and sales.

II. Governance

The Board of Directors or the principal executive officer, in case there is no Board of Directors, of the entity shall create and appoint the members of the Investment Committee or equivalent governing board.

The Investment Committee, or equivalent governing board, is the ultimate responsible for the creation, implementation and revision of investment policies for the respective entity. The Investment Committee should establish written procedures for the operation of the Investment Program, consistent with these broad Investment Policy Guidelines and any investment policies established by the Agency in conformity with these Guidelines. The Investment Committee should be comprised by three (3) members. Two (2) members shall have academic and/or professional background in finances and/or money market investments, preferably in fixed income type. At least one (1) member shall be an employee of the instrumentality, and if needed, the Committee may include an external party that meets the aforementioned professional criteria. The Investment Committee shall meet at least every 3 months.

In case where conflict arises between this Investment Policy Guidelines and internal policies established by the Agency or Component Unit, the stricter rule shall apply.

Procedures should include explicit delegation of the authority to persons responsible for investment transactions. No person or entity subject to these Investment Policy Guidelines may engage in an investment transaction, except as permitted under the terms of these Investment Policy Guidelines and those approved and established by the entity.

A. Investment Committee

1. Investment Committee

The Investment Committee of the entity is the responsible for overseeing all aspects of Investment Programs, including development and approval of IPS, and any changes made to it after its initial adoption. The Investment Committee is also responsible for the selection and supervision of the Investment Officer, and is authorized to retain such external experts as shall be necessary to develop, implement, and/or monitor implementation of the IPS. For entities that do not have a Board of Directors, an Investment Committee, or equivalent, should be designated as responsible for the Investment Program(s).

2. Roles and responsibilities of the Investment Committee

The Investment Committee shall be responsible for:

a. Developing policies that are suitable for achieving the strategic objectives set for the Investment Program (s);
b. Approving such policies and policy proposals that may be set forth by the Investment Office from time to time;
c. Seek approval from AAFAF on implementation and revision of IPS;
d. Reviewing and revising policies as required;
e. Establish a Proxy Voting and Soft Dollar policies, as applicable;
f. Lay out rules for disclosure of compensation arrangements between vendors; and
g. Designating / Selecting the Investment Officer.

B. Investment Officer

The Investment Officer shall be the primary responsible for the day-to-day operations of the Investment Programs and will be in charge of the management of the Investment Office.

1. Roles and responsibilities of the Investment Officer

The Investment Officer shall be responsible for:

a. Identifying and engaging outside experts and managers to implement programs intended to satisfy the strategic objectives;
b. Reviewing the IPS and investment policies and, as required, making recommendations for revisions to the Investment Committee;
c. Acting on the policy mandates of the Investment Committee, including developing and implementing the procedures required to do so;
d. Evaluate and communicate with potential third-party providers to determine whether they will be a good fit for the Investment Program(s);
e. Execute transactions and actively manage portfolio assets, in the case of portfolios managed by internal resources;
f. Supervise compliance for Proxy Voting and Soft Dollar policies, as applicable;
g. Supervise compliance of compensation arrangements between vendors, as applicable; and

h. All other duties designated by the Investment Committee.

2. Qualifications of the Investment Officer

The Investment Officer shall play a central part in the operation of Investment Programs. A qualified person for the position must demonstrate to have advanced investment skills, as well as relevant experience in roles related to investment management.

Suggested minimum qualifications for an Investment Officer are the following:

a. Graduate Degree or equivalent qualification in Business/Finance is preferred. In absence of such qualifications, the person must strictly meet the experience criteria set forth below;
b. At least 4 years of experience in finance and/or investment;
c. Strong financial, credit and portfolio management skills;
d. Excellent verbal and written communication skills;
e. Strong knowledge of various investment products; and
f. Genuine knowledge and commitment to the ethical standards set in the IPS.

3. Delegation of Authority

The Investment Committee may delegate to the Investment Officer the responsibility for the selection, monitoring and removal of investment firms engaged to manage the Investment Program's assets. The Investment Officer shall be responsible for ensuring that any such investment managers fulfill their mandates within the contractual obligations negotiated between the entity and the investment manager, including, but not limited to: investment guidelines that will be incorporated in each investment management contract, responsibilities of the investment manager, characteristics of the manager's style of investing, performance expectations; compensation, organizational requirements, reporting and other administrative requirements. The Investment Officer shall also be responsible for reporting on the status of each investment management firm retained at each quarterly meeting of the Investment Committee.

4. Asset Allocation Policy

Investment Programs shall be implemented with the aim of achieving the risk and return objectives in each asset class invested, at the lowest cost to the entity, safeguarding quality of execution as a priority. Since asset allocation can change over time as characteristics of the program change and market circumstances vary, the Investment Committee may include approved target allocations as an appendix to the IPS and are subject to revisions without the approval of a new IPS.

The Investment Committee shall modify target policy allocations from time to time by taking into consideration factors such as:

a. Projected cash needs;
b. Liquidity of assets in which the portfolio is invested;
c. Expected returns for asset classes considering expected and prevailing levels of inflation;
d. Expected correlation of asset returns and expected volatility of returns to assess appropriate diversification and sufficient expected returns within the risk parameters.

The Investment Committee is required to keep record of the assessment of the aforementioned factors, as well as backup analysis supporting the target allocations. For component units to engage in derivative transactions, written authorization from AAFAF is required.

5. Risk Management, Monitoring, and Reporting

The Investment Committee, or equivalent governing board, shall assign responsibility for executing risk management policies as established in the IPS.

For portfolios managed internally by the entity, the Investment Officer shall be responsible for monitoring investment positions relative to the risk tolerance limits established in the IPS and shall rebalance according to the procedures upon breach of tolerable risk variances.

For portfolios managed by external firms, the Investment Officer is responsible for monitoring and rebalancing portfolios in accordance to risk management policies. Such external firm is responsible to provide periodic reports of accounting positions, calculations of tracking error relative to the policy portfolio, and calculations of information ratios for each asset class and each investment manager account. Such reports must be provided at least on a quarterly basis.

The custodian bank shall provide an independent monthly accounting of positions, and may provide financial reports that contain, at a minimum: schedule of investment positions, cash position and transaction history for each custody account.

III. Investment, Return and Risk Objectives

The main objective of Investment Programs is typically achieving the risk and return objectives in each asset class invested, at the lowest cost and highest quality of execution.

Every entity may face unique circumstances, and Investment Programs are usually established for very specific purposes. The management of each entity, with the approval of the Investment Committee, shall establish risk and return objectives consistent with the objectives of each Investment Program.

The IPS must contain a careful specification of the overall investment performance objective, a description of funding needs, and its relationship to fundamental factors (such as inflation and spending rate). The IPS should set forth all permissible asset classes in which the portfolio may be invested. Although some asset classes may not be used at all times, they should still be identified in the IPS. For each asset class, a brief description of the class should be provided and a benchmark for performance should be identified. Within each asset class, there may be subordinate descriptions and benchmarks for subclasses that may be identified in the IPS or reserved for an asset allocation plan that may be attached as an appendix.

A. Investment strategy and risk/return objectives

a. Entities should be required to establish and have a clear purpose with main goals of each Investment Program.
b. Requirements for minimum available redemption (cash withdrawals) windows should be set to ensure that entities will be able to sell investments and safeguard their liquidity.

c. Investments in instruments issued by the Commonwealth or its instrumentalities or private entity participations with heavily concentrated investments in instruments issued by the Commonwealth are allowed at a maximum of 3% of portfolio, and only to be executed through active management.

B. Benchmark Selection

The Investment Committee shall be responsible to approve the selection of benchmarks for assessment of each asset class invested.

In order to be considered valid and compliant pursuant to these Investment Policy Guidelines, benchmarks should comply with the following characteristics:

a. *Unambiguous*: the identities and weights of securities or factor exposures constituting the benchmark are clearly defined.
b. *Investable*: it is possible to forgo active management and simply hold the benchmark.
c. *Measurable*: the benchmark's return is readily calculable on a reasonably frequent basis.
d. *Reflective of current investment opinions*: the manager has current investment knowledge (be it positive, negative, or neutral) of the securities or factor exposures within the benchmark.
e. *Specified in advance*: the benchmark is specified prior to the start of an evaluation period and known to all interested parties.
f. *Owned*: the Managers (as defined in Section I below) should be aware of and accept accountability for the constituents and performance of the benchmark. It is encouraged that the benchmark be embedded in and integral to the investment process and procedures of the Managers.

In addition to the aforementioned criteria, the Investment Officer should report on the costs and fees associated with the Investment Programs. Performance comparisons that shall be reported to the Investment Committee on a quarterly basis by the Investment Officer should reflect performance of the asset class' benchmark and performance of the portion of the portfolio allocated to the asset class, both gross and net of management fees. To the extent that multiple Managers are used for a single asset class, their performance shall be reported both individually and in aggregate. Performance measurement standards will adhere to the time-weighted methodology. Each asset class shall have a single performance benchmark associated with it, except that the Private Equity holdings shall use as a benchmark peer group indexes (which violate several of the characteristics required of benchmarks for other asset classes). Benchmarks for each asset class may be changed or modified only by the Investment Committee, and each benchmark shall be incorporated in each investment management agreement as the basis for evaluation of performance. The performance expectation for each Manager shall be documented as part of the investment management agreement.

C. Policy Portfolio

Each entity's Investment Committee shall approve and establish a target Policy Portfolio, which may be modified as needed. The Policy Portfolio is a baseline target mix that results from the process of allocating money to IPS- permissible asset classes that integrates the Investment Program's risk tolerance, and investment constraints with long-run capital market expectations. In the case of Investment Programs for

Defined Benefit Plans and Insurance Companies, such Policy Portfolios shall reflect results of actuarial studies.

The Investment Committee shall be responsible for assuring that the assets of the Investment Program are deployed in a manner consistent with the target Policy Portfolio, although this responsibility may be delegated to the Investment Officer. The Investment Officer shall provide a report to the Investment Committee by the fifth (5^{th}) business day of each new month that confirms the asset allocation of the Investment Program as of the end of the last day of the prior month. The Investment Officer shall also certify to the Investment Committee that portfolios did not exceed allowable ranges around the target established for each asset class during the month preceding. On a quarterly basis, the Investment Officer shall calculate and report the marginal performance contributed by variance from the target asset allocation.

Variances in allocation associated with relatively illiquid investments (primarily Private Equity and venture capital) are likely to persist during certain periods. Nevertheless, the Investment Committee must take adequate steps in addressing excessive allocation in such programs, especially in cases that deviations represent more than fifty percent (50%) of the target, as well as in times when significant cash outflows from the Investment Program are projected.

D. Risk Tolerance

The IPS should acknowledge that the portfolio will be subject to risk and have the potential for returns associated with risk to be both positive and negative over time. There are numerous forms of relevant risks and may include liquidity, legal, political, regulatory, longevity, mortality, and/or business. The Investment Committee must take into consideration its unique circumstances and exposures (for example: funding status, enrollment trends, obligations to policy holders, etc.) when defining risk tolerance and planning for asset allocation.

E. Relevant Constraints

1. Evaluation Horizon for Achievement of Performance Objectives

Although relatively short time periods may be used for monitoring performance, the Investment Committee shall establish minimum time horizons for achievement of performance objectives, in order to clarify when action may be needed to resolve underperformance issues. In view of that, short-term investment performance shortfalls are not necessarily of critical interest unless they suggest failures in strategy execution at investment management firms retained by the entity. Notwithstanding that possibility, the Investment Officer shall evaluate the Manager and asset class performance on a trailing twelve (12) month period, except for illiquid asset classes (private equity and real estate), which shall be evaluated on a trailing five (5) year period.

2. Requirements for Maintaining Liquidity

Each entity may have unique short or medium term needs for cash. Such needs must be specified in the IPS.

F. Allowable Assets

The following is a list of assets considered acceptable for investment, subject to the investment guidelines approved by the Board of Directors for each Investment Program:

1. Short Term Assets

a. U.S. Treasury bills;
b. U.S. Treasury notes or bonds with short term maturities;
c. Short-term obligations of U.S. government agencies and instrumentalities classified in the highest rating category of Standard & Poor's and Moody's;
d. Fully insured or collateralized certificates of deposit at eligible financial institutions designated by the Commissioner of Financial Institutions and the Secretary of the Treasury;
e. Certificates of Deposit or Euro Notes issued by financial institutions in the U.S. in which the issuer is classified in the highest rating category for short term obligations and in the two highest for long term obligations by at least two of the principal rating services as classified by S&P and Moody's;
f. Prime commercial paper rated A1/P1 by S&P and Moody's; and
g. Repurchase Agreement Transactions (Repo Transactions) - defined as transactions involving the purchase of securities with the agreement to resell the security back to the seller at a future date for a specific price.

2. Long Term Assets

a. Common stock and Preferred stock;
b. Exchange Traded Funds (ETFs);
c. Convertible bonds and Convertible preferred stocks;
d. Bank-sponsored short term investment funds;
e. Corporate bonds and notes;
f. Bonds and notes of the U.S. Government and its Agencies;
g. Mortgage pass-through securities guaranteed by the Government National Mortgage Association (GNMA), the Federal National Mortgage Association (FNMA) or the Federal Home Loan Mortgage Corporation (FHLMC), and collateralized mortgage obligations (CMO) backed by such agencies;
h. Asset-Backed Securities backed by the U.S. Government or its Agencies;
i. Real Estate: Property must be managed by external professional property managers. The Board of Directors must establish the appropriate regulations and guidelines for these investments; and
j. Private Equity/Venture Capital Funds: The Board of Directors must establish proper guidelines for these investments. Such assets must be managed by specialized firms.

The following assets and strategies should be employed strictly within the context of certain risk management, hedging and/or tactical allocation strategies. Such strategies must be professionally implemented and managed through professionals and organizations with demonstrated expertise in the management of such asset classes:

a. Futures
b. Forwards

c. Options
d. Interest Rate Swaps
e. Caps
f. Floors

G. Prohibited Assets and Transactions

Prohibited investments include, but are not limited to the following:

a. Direct Investment in Commodities
b. Uncovered Options
c. Limited Partnerships
d. Direct participation in individual businesses
e. Direct participation in real estate investments
f. Positions in foreign Currencies

1. Leverage

The use of any form of leverage, including contracts to replicate leveraged positions, is strictly prohibited. Leverage is defined as a level in excess of capital invested in that asset or exposure to any asset in excess of market value appreciation on the asset.

2. Securities Lending

Securities lending are generally acceptable subject to guidelines approved and established by the entity's Board of Directors. Any such participation will require that loaned securities be collateralized at no less than one hundred three percent (103%) of market value, be marked to market daily, with U.S. Treasury Securities.

Securities lending activities must be discontinued under the following circumstances:

a. The Investment Office project significant cash outflows from the Investment Program; or
b. The manager of assets under a securities lending program is on watch for underperformance.

H. Investment Philosophy

The IPS should document the investor's philosophical approach to investing, which may include such dimensions as market efficiency; desirability for inclusion of environmental, social, and/or governance (ESG) factors in decision making; interest in the inclusion of local service providers; and so on.

I. Evaluating and Selecting Qualified Investment Managers

Once the Board of Directors and/or Investment Committee has formally established its investment objectives, policies and guidelines concerning the assets of the individual Investment Program in a detailed IPS, the Board of Directors or the Investment Committee may evaluate and select Investment Manager(s) for policy implementation.

In reviewing the qualifications of manager candidates, the Board of Directors or Investment Committee should analyze firms from a qualitative and quantitative point of view. The Manager must have a viable organizational structure capable of supporting the investment activities of the Investment Program. It is important to conduct a business evaluation of the Manager and to analyze the adequacy of its personnel. The Manager must also have professionals with extensive educational preparation and practical experience in the field of investment management. Aside from these criteria, the Manager must be able to articulate a clear, logical investment philosophy and process. The Manager must also have a demonstrated ability of implementing its investment process successfully.

In considering quantitative criteria, the Board of Directors or Investment Committee must evaluate risk-adjusted performance over long term (five and seven years are indicative of long-term performance, as is ten years) and short term periods (one and three years). Performance measurement standards will adhere to time-weighted methodology.

Before hiring a Manager, it must acknowledge in writing the receipt of and intent to comply with the Investment Policies Guidelines stated in this document as well as with the Investment Program's specific IPS. In engaging the services of the Manager and other service providers in the investment management process, the Investment Committee must make sure that compensation is consistent with industry, considering type and level of services.

J. Responsibilities of the Investment Manager

Managers are responsible for the discretionary management of the Investment Program's assets, in accordance to these Investment Policy Guidelines and the program-specific IPS. The Manager's on-going responsibilities will primarily include investment asset allocation, security selection and appropriate cash allocation as set forth on the governing documents.

The Manager must diversify the portfolio holdings according to the diversification guidelines established in these Investment Policy Guidelines, as well as to the IPS for the applicable Investment Program. If the overall strategy for the long-term funds of the Investment Program included the hiring of a Manager with a particular equity or fixed income style or of Managers with complementary styles, each Manager must maintain the style and relative portfolio characteristics for which it was hired.

Managers must always conduct all security trading transactions on a "best execution" basis. The Manager must never execute any transactions through affiliate brokerage firms or those in which it may have an economic interest. They are also required to provide quarterly notifications to the Investment Committee and Investment Officer listing the portfolio's activity and trading costs. Managers must also reconcile with the Custodian at least on a quarterly basis, with an explanation of any discrepancies and how they will be resolved.

The Manager must meet at least twice a year with the Investment Officer for the Investment Program, as well as whenever it is considered necessary, in order to make a presentation on the economic climate in relation to the investment strategy pursued and the resulting performance and discuss the investment strategy and portfolio holdings being used to fulfill the stated objectives.

The Manager must inform the governing board of the Investment Program of any material changes, including any loss of key investment personnel, material change in the financial position or other challenges involving the organization.

K. Evaluating and Selecting a Qualified Consultant

Each entity should engage with an Investment Management Consultant ("Consultant") that can assist the Investment Committee carry out its fiduciary obligations in supervising the assets of the Investment Program. The following criteria must be considered in the selection process:

a. Organizational strength and structure
b. Experience
c. Client Base
d. References
e. Professional staff
f. Consulting philosophy
g. Economic and Investment Research Capabilities
h. Performance Measurement and Analysis
i. Reports
j. Investment Manager Search and Selection Process
k. Investment Manager Due Diligence Process
l. Client Service
m. Fees
n. Professional Liability Insurance

Institutions participating as brokers or dealers, registration with the SEC will be mandatory. Due to the nature of the structure of some advisory institutions, such registration will not be required; in such cases adherence to any other pertinent rules must be followed.

L. Responsibilities of the Consultant

The following are some of the responsibilities of the Consultant:

a. Promote a clear understanding by all parties and especially the Manager, of the investment objectives of the Investment Program;
b. Assist the Board of Directors and the Investment Committee in formulating and administering investment policy, analyzing existing investments, selecting new Managers and educating the staff, the Investment Committee and Investment Officer on investment issues, capital markets, and fiduciary responsibilities;
c. Facilitate an understanding of the capital markets in order to provide the Board of Directors with a better perspective from which to make informed investment decisions;
d. Review the IPS for the total portfolio and individual Managers from time to time in order to ensure the continued relevance and feasibility of the investment objectives, policies and strategies and to recommend changes when necessary;
e. Review the investment portfolios, on a quarterly basis, to ensure compliance with the guidelines and limitations in the IPS and to promptly communicate violations to the Board of Directors;
f. Monitor the progress of the portfolio versus investment objectives over market and economic cycles;

g. Perform due diligence on the Manager in order to ensure their continued overall quality as an organization, focusing on qualitative as well as quantitative aspects; and
h. Provide performance measurement and performance attribution services, using custodian-provided data, thus assuring the basis for an independent analysis of investment performance. A report analyzing performance for the overall fund and for each portfolio segment should be provided on a quarterly basis.

M. Evaluating and Selecting a Qualified Custodian

Each entity should engage with a qualified banking institution that can provide custody and all the related services required by an Investment Program. The Custodian search and evaluation should focus on the following criteria:

a. Organizational strength and structure
b. Experience
c. Client Base
d. References
e. Professional staff
f. Accounting and reporting
g. Cash Management
h. Custody and Safekeeping
i. Securities Lending
j. Controls and Procedures
k. Systems Capabilities
l. Fees
m. Insurance

N. Responsibilities of the Custodian

The professional management of the Investment Program must be accompanied by the engagement of a qualified banking institution that can support the custody-related aspects of the investment process. The Custodian must be nationally-recognized for its leadership and expertise in the custody and related services for professionally-managed investment portfolios.

Among other duties, the Custodian is charged with ensuring the timely settlement of all transactions, crediting of payments, and providing transaction confirmations and monthly statements, which reflect all transactions and the investment portfolio as of month-end.

IV. Compliance

Each entity in charge of one or more Investment Programs, as defined herein, has the obligation to observe these Investment Policy Guidelines and certify its compliance on an annual basis.

On or before August 31th of each year, the entity's Board of Directors or Senior Management designee shall submit to AAFAF a *Declaration of Compliance with Investment Policy Guidelines*. At a minimum, such Declaration shall include the following:

a. A representation of adherence to the Investment Policy Guidelines approved and established by the entity;
b. A statement of enactment of an Investment Committee along with the names and credential of each member;
c. The name and credentials of the appointed Investment Officer;
d. A copy of the IPS; and
e. The following Portfolio reports:
    1. Account Statements
    2. Schedule of Investments
    3. Asset Allocation Summary
    4. Portfolio Performance and Analytics

V. Adoption of this Statement

These Investment Guideline Policies were adopted on February 8, 2019, pursuant Resolution 2019-11, by the Board of Directors of AAFAF.

This document revokes any other investment guideline or policy established previously by the entity.

VI. Glossary[i]

Active management - An approach to investing in which the portfolio manager seeks to outperform a given benchmark portfolio.

Asset allocation - The process of determining how investment funds should be distributed among asset classes.

Asset Backed Securities (ABS) - A type of bond issued by a legal entity called a special purpose vehicle (SPV), on a collection of assets that the SPV owns. Also, securities backed by receivables and loans other than mortgage loans.

Asset class - A group of assets that have similar characteristics, attributes, and risk/return relationships.

Benchmark - A comparison portfolio; a point of reference or comparison. In an investments context, a standard or point of reference for evaluating the performance of an investment portfolio.

Bond (Conventional) - A type of security that represent an agreement between issuer and holders, in which the issuer makes periodic fixed coupon payments during the contract's life and a lump-sum payment of principal at maturity.

Caps - A combination of interest rate call options designed to hedge a borrower against rate increases on a floating-rate loan.

Certificate of Deposit - An instrument that represents a specified amount of funds on deposit with a bank for a specified maturity and interest rate. It is issued in small or large denominations, and can be negotiable or non-negotiable.

Collateralized Mortgage Obligation (CMO) - A security created through the securitization of a pool of mortgage-related products (mortgage pass-through securities or pools of loans).

Commodities - Articles of commerce such as agricultural goods, metals, and petroleum; tangible assets that are typically relatively homogeneous in nature.

Common Stock - A type of security that represent an ownership interest in a company.

Credit Default Swaps - A type of credit derivative in which one party, the credit protection buyer who is seeking credit protection against a third party, makes a series of regularly scheduled payments to the other party, the credit protection seller. The seller makes no payments until a credit event occurs.

Currency - Monies issued by national monetary authorities.

Custodian - An entity that effects trade settlement, safekeeping of assets, and the allocation of trades to individual custody accounts.

Defined Benefit Retirement Plan - Plan in which the company promises to pay a certain annual amount (defined benefit) to the employee after retirement.

Defined Contribution Retirement Plan - Individual accounts to which an employee and typically the employer makes contributions, generally on a tax-advantaged basis. The amounts of contributions are defined at the outset, but the future value of the benefit is unknown. The employee bears the investment risk of the plan assets.

Derivatives - A financial instrument whose value depends on the value of some underlying asset or factor (e.g., a stock price, an interest rate, or exchange rate)

Direct Investment in Commodities - Commodity investment that involves the cash market purchase of physical commodities or exposure to changes in spot market values via Derivatives, such as futures.

Environmental, Social or Governance (ESG) - Also called socially responsible investing, refers to the explicit inclusion of ethical, environmental, or social criteria when selecting a portfolio.

Euro Notes - Type of note issued internationally, outside the jurisdiction of the country in whose currency the bond is denominated.

Floors - A combination of interest rate options designed to provide protection against interest rate decreases.

Forward Contract or Forwards - Agreement between two parties in which one party, the buyer, agrees to buy from the other party, the seller, an underlying asset at a later date for a price established at the start of the contract.

Future Contract or Futures - Variation of a forward contract that has essentially the same basic definition but with some additional features, such as a clearinghouse guarantee against credit losses, a daily settlement of gains and losses, and an organized electronic or floor trading facility.

Hedge - A general strategy usually thought of as reducing, if not eliminating, risk.

Interest Rate Swap - A swap in which the underlying is an interest rate. Can be viewed as a currency swap in which both currencies are the same and can be created as a combination of currency swaps.

Investment Policy Statement - (IPS) A written planning document that describes a client's investment objectives and risk tolerance over a relevant time horizon, along with constraints that apply to the client's portfolio.

Investment Program – Investment activities associated with subdivisions and component units of the Commonwealth to which these guidelines are applicable.

Liquidity - The ability to purchase or sell an asset quickly and easily at a price close to fair market value. The ability to meet short-term obligations using assets that are the most readily converted into cash.

Option Contract or Options - Financial instrument that gives one party the right, but not the obligation, to buy or sell an underlying asset from or to another party at a fixed price over a specific period of time.

Policy Portfolio - A baseline portfolio target mix that results from the process of allocating money to IPS- permissible asset classes that integrates the Investment Program's risk tolerance, and investment constraints with long-run capital market expectations.

Preferred Stock - A type of equity interest which ranks above common shares with respect to the payment of dividends and the distribution of the company's net assets upon liquidation. They have characteristics of both debt and equity securities. Also called preferred shares.

Private Equity - Investments that are not listed on public exchanges and have no active secondary market. They are issued primarily to institutional investors via non-public offerings, such as private placements.

Proxy Voting - A process that enables shareholders who are unable to attend a meeting to authorize another individual to vote on their behalf.

Repurchase Agreement - A form of collateralized loan involving the sale of a security with a simultaneous agreement by the seller to buy the same security back from the purchaser at an agreed-on price and future date. The party who sells the security at the inception of the repurchase agreement and buys it back at maturity is borrowing money from the other party, and the security sold and subsequently repurchased represents the collateral.

Risk - Exposure to uncertainty. The chance of a loss or adverse outcome as a result of an action, inaction, or external event.

Soft Dollars - The use of commissions to buy services other than execution services. Also called soft dollar arrangements or soft commissions.

Swap Contract or Swaps- Agreement between two parties to exchange a series of future cash flows.

Time-weighted rate of return - The compound rate of growth of one unit of currency invested in a portfolio during a stated measurement period; a measure of investment performance that is not sensitive to the timing and amount of withdrawals or additions to the portfolio.

Total Return Swap - A swap in which one party agrees to pay the total return on a security. Often used as a credit derivative, in which the underlying is a bond.

Tracking error - The standard deviation of the differences between a portfolio's returns and its benchmark's returns; a synonym of active risk. Also called tracking risk.

Uncovered Options - A strategy where an owner of an option does not have an offsetting position in the underlying asset.

Volatility - The standard deviation of price outcomes associated with an underlying asset.

---

[i]Excluding *Investment Program* and *Policy Portfolio* all terms in this glossary were sourced from:
CFA Institute. (2018). Retrieved from CFA Institute:
https://www.cfainstitute.org/en/programs/cfa/curriculum/glossary