# The Master Statement of Investment Policies and Objectives of The Lower Colorado River Authority Retirement Plan and Trust

Amended June 16, 2015

## Introduction

The Lower Colorado River Authority ("LCRA") is a conservation and reclamation district created by the Legislature of the State of Texas in 1934.

Pursuant to the enabling legislation of LCRA, the powers, rights, privileges, and functions of LCRA are exercised by the Board of Directors. The Board of Directors has the responsibility for and the authority to establish policies to guide management of LCRA affairs.

The Board of Directors approved the Lower Colorado River Authority Retirement Plan and Trust, as most recently amended and restated effective April 1, 1994, ("the Plan") Section 9.01 of the Plan created the Board of Trustees (the "Board"). The Board was delegated the responsibility to administer the Plan in accordance with its terms, and all powers necessary to accomplish that purpose including, but not limited to, the right, power and authority to: **(1)** employ and supervise an investment consultant to assist the Board in the selection and ongoing evaluation of one or more investment managers, the establishment of investment objectives and guidelines, and the allocation of Plan assets among the various investments, and **(2**) select, employ and compensate, from time to time, such pension trust consultants, actuaries, accountants, attorneys, and investment managers, as the Board may deem necessary and advisable for the proper and efficient administration of the Plan.

Investment consultants, investment managers, and other consultants (collectively, "Consultants") employed by the Board shall act in accordance with the provisions of the Plan. Consultants shall discharge their duties solely in the interest of participants and beneficiaries of the Plan: (1) for the exclusive purpose of (a) providing benefits to participants and their beneficiaries; and (b) defraying reasonable expenses of administering the Plan; (2) with the care, skill, prudence, and diligence under the prevailing circumstances that a prudent expert acting in like capacity and familiar with matters of the type would use in the conduct of an enterprise with a like character and like aim; (3) by diversifying the investments of the Plan to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and (4) in accordance with the documents and instruments governing the Plan to the extent that the documents and instruments are consistent with governing laws. Consultants shall act in accordance with the applicable laws of the State of Texas as to conduct, management and diversification, which shall apply to each Consultant in the discharge of its duties relative to the management of the assets of the Plan.

Investment managers are granted discretionary authority to manage assets of the Plan for the Board. Among other things, this Master Statement establishes policies regarding the current asset allocation strategies of the Plan and the duties and obligations of investment managers.

The Board reserves the right to terminate an investment manager at any time, for any reason.

Investment managers must manage the Plan assets according to the investment philosophy as presented to the Board when hired. No deviation from stated philosophy is authorized unless first discussed with the Board and its independent investment advisor, and the prior written consent of the Board in each instance is obtained.

## Purpose & Objectives

The Plan is administered by the Board. The Plan is a defined benefit pension plan maintained to provide retirement benefits and/or death benefits, as the case may be, to participants and their beneficiaries.

The Board is charged by law with the overall responsibility for the administration of the assets of the Plan. To assist the Board in this function, it is authorized and permitted to delegate certain of its responsibilities to investment manager(s) who possess the necessary specialized research facilities and skilled professionals, to act as prudent experts in investing the assets of the Plan.

In keeping with responsibilities under applicable laws, one of the purposes of this Master Statement is to define the Plan’s investment objectives, and discuss the Plan’s tolerance for risk and volatility. Another is to communicate clearly to the investment manager(s) certain of their duties and responsibilities, and the investment objectives of this Plan.

## Investment Objectives

The primary goal of the Plan is to provide participants and their beneficiaries with retirement benefits according to provisions of the Plan. The Plan’s assets must be invested with the care, skill and diligence that a prudent expert acting in this capacity would undertake. The overall investment objective of the Plan is to invest the funds in such a manner as to achieve a reasonable growth of the corpus while maintaining a consistent payout capability. This should be achieved within the framework of the Master Statement consistent with the Plan’s general objective of safety and preservation of principal. The minimum expected total return is the actuarial assumption approved by the Board on an annualized basis. The actuarial rate of return is a figure that should be net of expenses. This objective should be pursued as a long-term goal designed to maximize the benefits available without exposure to undue risk.

The Board understands that fluctuating rates of return are characteristic of the securities markets. The Board expects the total portfolio to achieve the following objectives over a five-year rolling average:

1. The annual total return objective should be greater than the actuarial assumption.

2. The investments of the total Plan (as defined as the market value by the annual audit report) should produce a total return equal to or greater than the custom index. The **custom index** is defined as an index designed to match the asset allocation of the Plan by replacing each asset class with the corresponding percentage of index returns.

**Plan asset allocation:**

**22% Large cap domestic equities, 5.5% Small cap domestic equities, 15% Long/Short equity, 27.5% International equities, 15% Domestic fixed income, 10% Absolute Return, and 5% Global fixed income.**

**Benchmark custom index:**

**22% S&P 500 Index, 5.5% Russell 2000 Index, 15% HFRI Equity Hedge, 27.5% MSCI All Country World Index, 15% Barclays Capital Aggregate Index, 10% HFRI FOF Conservative, and 5% Citigroup World Government Bond Index.**

3. The risk assumed by the total portfolio should be similar to that of the custom index.

## Guidelines and Restrictions

The Board intends to use the Master Statement as a framework to help the manager(s) achieve the investment objectives of the Plan at a level of risk the Board deems acceptable.

The Board expects the Plan's asset allocation to reflect the investment objectives and risk tolerances expressed throughout the Master Statement. These policies, developed after examining the historical relationships of risk and return among asset classes and integrating an analysis of both assets and liabilities, are designed to provide the highest probability of meeting or exceeding the Plan's return objectives at an acceptable level of risk. Although dynamic capital markets may cause fluctuating risk/return opportunities over a market cycle, the following standards will be used as a flexible framework for asset allocation (as measured at market value) over a five-year rolling average:

The asset allocation may shift plus or minus Ten percent (+ or - 10%) from the target asset allocation. The asset allocation will be monitored quarterly and readjusted as necessary.

These guidelines shall be reviewed periodically, and can be changed by the Board at any time. The investment managers, at any time, will be notified of any changes and will have a maximum of 30 days to comply.

1. Large cap domestic equity manager weighting (including all convertible securities) shall target 22% of the total Plan's market value with a range of 12% to 32%. Equity manager(s) shall be fully invested as described in paragraph 5 below.

2. Small cap domestic equity manager weighting (including all convertible securities) shall target 5.5% of the total Plan's market value with a range of 0% to 15.5%. Equity manager(s) shall be fully invested as described in paragraph 5 below.

3. Long/Short equity manager weighting shall be 15% of the total Plan's market value with a range of 5% to 25%.

4. International equity manager weighting shall target 27.5% of the total Plan's market value with a range of 17.5% to 37.5%.

5. Domestic fixed income securities shall target up to 15% of the total Plan's market value with a range of 5% to 25%.

6. Absolute Return manager weighting shall be 10% of the total Plan's market value with a range of 0% to 20%.

7. Global fixed income manager weighting shall be 5% of the total Plan's market value with a range of 0% to 15%.

8. Use of cash and equivalents will be restricted to a maximum of 5% of the assets managed by the investment manager. Funds to be used for liquidity purposes such as benefit payments or pending investments will be made in short term funds by the custodian. These investments will be considered part of the fixed income portfolio to determine the compliance with the target asset allocation.

9. Assets invested in commingled vehicles will be subject to the specific restrictions of the vehicles used for investment by the Plan. Given the commingled nature of the assets, they will not be subject to specific restrictions set forth by this document.

## Domestic Equities

The Board will hire investment managers based on a number of criteria including an evaluation of their investment philosophy, long-term performance, ability to compliment existing portfolio styles and the need to diversify management philosophies. All investment managers shall adhere to their stated investment philosophies as presented when selected.

All equity investments shall be made within the guidelines of quality, marketability, and diversification mandated by ERISA and applicable legal requirements.

For domestic equity managers, equity holdings may be selected from the New York, American and Regional Stock exchanges, and the NASDAQ markets. Foreign securities may be purchased on these exchanges, as long as proper liquidity is available.

The maximum exposure to American Depository Receipts will be limited to 5% (at cost) of each domestic equity manager portfolio. No investment manager may concentrate more than 5% (at cost), of the assets under management, of any one issue of one equity account. Also, no manager may concentrate more than 30% of the assets under its management, at market value, in any one sector.

The manager(s) are prohibited from investing in letter stock, and uncovered options; or from engaging in short sales, margin transactions or other specialized investment activities. Options and futures can be used for hedging the portfolio, but in no way can these be used for speculation. The Board expects the manager(s) to produce returns higher than their benchmark and median of peer group, without incurring excessive risk, over a 5 year rolling average. Each manager will be provided with an appropriate benchmark index and peer group.

Within the above guidelines, the Board gives the manager(s) full discretion over security selection and diversification.

The Board recognizes that there are a variety of investment management styles employed by different investment managers. The Board seeks to retain managers whose styles are complementary to each other. The Board anticipates that this approach will reduce overall volatility and improve consistency of performance over market cycles.

## Definitions

**Growth –** The managers' primary goal is long-term growth of capital. They achieve this by investing in companies that have excellent potential for high rates of future earnings growth. The companies are typically established in their industry and have new or renewed growth potential. The managers may take above-average risk in order to capture the long-term growth potential of a stock or an industry. Because of this, the rates of return on the funds may vary substantially on both the up- and down-side.

**Value** – These managers seek to capture both capital appreciation and current income. The stocks held by these managers pay consistent dividends and have potential for long-term growth in earnings and capital. Typically, the stocks are either "blue chip" type companies that are well-established and have profit levels high enough to maintain high dividend yield, or they may be companies that are believed to be undervalued with regards to basic fundamentals and their current stock price. This strategy will typically maintain average equity risk exposure; thereby the investment returns should experience less dramatic swings than in the Growth strategy.

**Core Equity** – Equity investments utilizing fundamental financial analysis to select stocks exhibiting relative value compared to other stocks in similar industries. Core equity management makes small percentage investments in each stock utilizing selection criteria to select Value and/or Growth stocks with the objective of exceeding the rate of return of the S&P 500 Index with the same or less volatility than the S&P 500 Index.

**Small Cap** – Equity investments that generally assume risk that is greater than the overall market risk. Market capitalization is generally less than $1 billion. Historically, over long periods of time, small stocks provide higher rates of return to compensate investors for higher volatility. Single product lines and "new" management contributes volatility to market cycles. Because of large market bets, gains or losses can be experienced in short periods of time. Financial leverage, research and development, and low dividends are common characteristics.

## Long/Short Equity

**Long/Short Equity** – Investment managers may be selected for the purpose of investing in the global equities both long and short. The Board may select either commingled portfolios or limited partnerships for this area. These strategies are generally characterized by lower correlation with traditional asset classes, higher expected risk-adjusted returns, and the ability to buy and sell stocks while hedging market exposures. These strategies generally have better downside risk protection than other long-only equity-oriented strategies.

## International Equity

**International Equity** – Investment managers may be selected for the purpose of investing in the equities of non-U.S. companies which may include emerging markets. The Board may select either commingled portfolios or separate accounts for this area. Often, custodial account complexity is lower and more cost effective with commingled investments. The Board understands that the participation in the relevant markets involves potential for variability of returns higher or lower than, and often uncorrelated to, those experienced in the U.S. markets.

All international equity investments shall be made within the guidelines of quality, marketability, and diversification mandated by ERISA and applicable legal requirements.

**Separate Account Restrictions**

1. Common Stocks of foreign corporations may be purchased on appropriate exchanges as long as proper liquidity is available. A maximum of 20% of the international equity manager portfolio may be invested beyond the MSCI EAFE index countries.

2. No investment manager may concentrate more than 5% (at cost) in any one account, of the assets under management, in any one security.

3. Also, no manager may concentrate more than 30% of the assets under its management, at market value, in any one sector.

4. American Depository Receipts (ADR's) representing ownership in foreign corporations are permitted.

5. Warrants and securities convertible into common shares of corporations are permitted. (Maximum 15% of total account).

The foreign currency exposure of the portfolio may be hedged back to the U.S. dollar using forward foreign exchange contracts. The manager may hedge 0% to 100% of the foreign currency exposure of the portfolio. The commercial and investment banks used for hedging transactions must be rated A/A2 or better by Standard & Poor's or Moody's.

The manager(s) are prohibited from investing in letter stock, and uncovered options; or from engaging in short sales, margin transactions or other specialized investment activities (options and futures can be used for hedging the portfolio, but in no way can these be used by leverage or speculation without written permission).

The Board expects the manager(s) to produce returns higher than their benchmark and peer group, without incurring excessive risk, over a 5-year rolling average.

**Fixed Income (Domestic and Global)**

Investments in fixed income securities will be managed actively to pursue opportunities presented by changes in interest rates, credit ratings, and maturity premiums. The manager(s) may select from appropriate debt securities. These investments will be subject to the following restrictions and considerations when held in a separate account:

**Separate Account Restrictions**

1. Long-term preservation of capital is the primary concern when making any fixed income investment.

2. Fixed income securities may include governments, agencies, mortgage pass throughs, corporates and asset backed.

3. The bond portfolio must have a minimum average quality rating of AA (AA by Standard & Poor’s and AA2 by Moody’s). Only up to 20% (of market value) can be purchased or held of securities rated between BBB- (Standard & Poor’s) or BAA3 (Moody’s) and BBB+ (Standard & Poor’s) or BAA1 (Moody’s). No securities shall be purchased below rating of either BBB- (Standard & Poor’s) or BAA3 (Moody’s). (A split-rated issue is considered to have the lower-rated designation.) In the event that a security held in the portfolio falls below the minimum quality rating of BBB- (Standard & Poor’s) or BAA3 (Moody’s), the investment manager must take action to remove the security from the portfolio within 90 days absent a subsequent upgrade of the security to within the policy guidelines. At no time may the investment manager hold more than 3% of the market value of the fixed income portfolio in securities that have fallen below BBB- (Standard & Poor’s) or BAAA3 (Moody’s).

4. At the time of purchase, no fixed income securities issuer, except the U.S. Government and agencies, may represent more than 5% of the market value of the assets in the portfolio.

5. Commercial paper investments must not be rated lower than P-1 and A-1 by Moody’s and Standard & Poor’s, respectively. Other short-term obligations shall be of comparable quality.

6. Each manager’s performance objective is to outperform the benchmark index and appropriate peer group over a 5 year rolling average.

7. Within the above restrictions, managers have complete discretion over timing and selection of fixed income securities.

The manager(s) are prohibited from investing in private placements, from speculating in fixed income or interest rate futures (options and futures can be used for hedging the portfolio but in no way can these be used for leveraging or speculation) from arbitrage or any other specialized investments.

The maximum exposure to mortgage-backed securities is 50% of the domestic fixed income manager’s account.

The maximum exposure to foreign debt securities is 5% of the domestic fixed income manager’s account.

For Global Fixed Income Managers, the Board will select either commingled portfolios or mutual funds.

## Absolute Return

**Absolute Return** – Investment managers may be selected for the purpose of investing in strategies that seek to return a positive absolute return over time regardless of market environment. Absolute Return seeks to provide consistent, stable streams of investment returns through the use of arbitrage and other non-directional strategies Managers will invest in numerous strategies including but not limited to: Event Driven, Merger Arbitrage, Long/Short Credit, Long/Short Market Neutral, Distressed, and Convertible Arbitrage. The Board may select either commingled portfolios or limited partnerships for this area.

## Benchmarks

Each investment manager will receive a copy of this Master Statement as well as a benchmark index and peer group identified in the investment management contract. In general, the following benchmarks and peer group universes will be used to measure performance.

| | Index | Universe |
|---|---|---|
| Domestic Core Equity | S&P 500 | Large Cap Core |
| Domestic Growth Equity | Russell 1000 Growth | Large Cap Growth |
| Domestic Value Equity | Russell 1000 Value | Large Cap Value |
| Domestic Small Capitalization Growth | Russell 2000 Growth | Small Cap Growth |
| Domestic Small Capitalization Value | Russell 2000 Value | Small Cap Value |
| Long/Short Equity | HFRI Equity Hedge | |
| International Equity Growth | EAFE Growth | International Equity |
| International Equity Value | EAFE Value | International Equity |
| Emerging Market Equity | MSCI Emerging Market Equity | Emerging Markets Equity |
| Domestic Fixed Income | BC Aggregate | Intermediate Fixed Income |
| Absolute Return | HFRI FOF Conservative | |
| Global Fixed Income | Citigroup World Government Bond Index | Global Fixed Income |

## Investment Managers

Investment manager(s) are expected to carefully follow the instructions and asset allocation parameters expressed in writing by the Board. If these written instructions are not clear, the investment manager(s) are to contact the Board and the independent investment advisor immediately.

## Authority

Consistent with this Master Statement, the investment manager(s) shall be responsible for making decisions on a fully discretionary basis. This includes buy, hold, sell, and timing decisions.

Each investment manager is directed to vote all proxies for securities held for the Plan so long as, in the investment manager's belief, the result of the ballot would serve to increase the value of the investment for the Plan. Investment managers are required to submit to the Board and the independent investment advisor a written summary of balloting on an annual basis. The Board reserves the right to vote proxies for securities held for the Plan, if desired by the Board.

## Communications

The Board will receive the following communications:

1. The custodial trustees shall provide the Plan's administrator and independent investment advisor monthly statements. The statements shall reflect cost and market values of all positions, industry segmentation and percentage composition of the portfolio represented by each issue. The Board shall be provided reports based on these custodial trustee statements.

2. Performance appraisal reports will be furnished quarterly by the independent investment advisor, to the Board.

3. Investment manager(s) shall meet with the Board upon request, to discuss results, economic outlook, investment strategy and tactics, organizational changes, market environment and any other pertinent matters.

4. The Board welcomes comment from each investment manager on the efficiency of service and quality of execution provided by all broker/dealers. On an annual basis, each investment manager shall provide a statement describing the methodology utilized by it to determine that the Plan has received best execution on transactions.

5. On a quarterly basis, the independent investment advisor shall provide a comprehensive independent performance appraisal report to the Board on each manager(s) and the total investment Plan detailing returns, risk, and an analysis of the entire investment process.

6. At its discretion, the Board may request any or all investment manager(s) and/or the performance appraisal firm to meet with the Board to review and discuss other aspects of fund performance.

7. Investment managers must advise the Board, its Chair and its independent investment advisor, in writing and in each instance, of any changes in the investment manager's organization, decision making structure, ownership, investment style, key personnel or any other material change and state the anticipated impact on the investment manager's ability to provide the same style and type of management on a continuing basis in the future.

## Amendments and Review

The Board shall review the Master Statement periodically, amending it as necessary, with full advice from the investment manager(s) and the independent investment advisor.

If at any time an investment manager(s) feels that these guidelines and related investment objectives and the attached amendments for the individual investment manager(s) are too restrictive or unreasonable, it shall immediately notify the Board in writing. By initial and ongoing review and acceptance of these provisions, the investment manager(s) agree to work within their specifications with their content and intent.

## Implementation

New investment manager(s) will adhere to the Master Statement immediately upon receipt of funds. Once an investment manager(s) is in compliance, it must stay in compliance.