EMPLOYEES' RETIREMENT SYSTEM
The Maryland-National Capital Park and Planning Commission
6611 Kenilworth Avenue, Suite 100
Riverdale, Maryland 20737
(301) 454-1415 - Telephone
(301) 454-1413 - Facsimile
http://ers.mncppc.org

STATEMENT OF INVESTMENT POLICY

General

The Maryland-National Capital Park and Planning Commission (M-NCPPC) Employees' Retirement System (ERS), has established the Employees' Retirement Fund (the Fund) to provide for the future retirement benefits of Plan participants. The Fund shall be administered solely in the interest of its participants and beneficiaries and shall comply with appropriate fiduciary standards.

With respect to the Fund, the Board of Trustees (the Board) is authorized to formulate investment policies, develop investment manager guidelines and objectives, and approve the retention of qualified advisors and investment managers. This Statement of Investment Policy and the related Manager Guidelines and Objectives provide a framework for performing these functions.

The Fund shall be principally managed by professional investment managers or invested in professionally managed investment vehicles. In addition, the Board may, from time to time, directly invest a portion of the Fund.

Investment managers will have discretion within the constraints of these Policies and Guidelines and will be subject to regular review by the Board. Fund assets should be invested to obtain an appropriate long-term total return consistent with the overriding goal of limiting the risk of a large loss. Special emphasis on liquidity or current income is not required, except as needed to meet obligations for pension benefit payments.

Investment Policy

The Fund shall be diversified across investment classes and among investment managers in order to achieve an optimal balance between risk and return. The Board approved the following target allocations for each asset class in the first quarter of 2009. In accordance with this Policy, the Board has established the following target allocations for each asset class, as well as ranges of expected exposure:

Asset Class	Target Exposure	Expected Range
U.S. Equities - Large Cap	28%	25% - 31%
U.S. Equities - Small and Mid Cap	7%	4% - 10%
Total U.S. Equities	**35%**	**30% - 40%**
International Equities	**20%**	**17% - 23%**
Total Equities	**55%**	**50% - 60%**
U.S. Investment Grade Fixed Income	25%	20% - 30%
High Yield & Opportunistic Fixed Income	10%	7% - 13%
Total Fixed Income	**35%**	**25% - 35%**
Private Real Estate	5%	0% - 10%
Private Real Assets	5%	0% - 8%

It is expected that the target allocations will be adopted in phases over a 12 month period based on market liquidity and the Board manager selection process.

Managers will, for the most part, specialize in one asset class, and all assets managed by a given manager will be considered committed to that asset class, even if the manager holds other assets, such as cash. The assets of a manager with a multi-asset class assignment – e.g. a tactical asset allocation (TAA) manager – will be considered committed to asset classes in proportions determined by the manager's performance benchmark.

The Fund's asset allocation shall be reviewed by the Investment Committee and the Board at the regularly scheduled, annual investment review meeting and at any other time the Committee or the Board considers appropriate. A review will consist of a comparison of each allocation to its target and expected range. If any allocation is out of its expected range, action will be taken to move the allocation closer to the target. Similarly, if an allocation is close to being out of the expected range, action to move the allocation will be considered and taken if deemed appropriate given market conditions and the Fund's investment objectives.

Investment Objectives

The long-term investment objective of the Fund is to achieve a total rate of return, net of fees, which exceeds the actuarial return assumption used for funding purposes by at least 1% per annum, and which exceeds the rate of inflation by at least 4% per annum. In addition, the Fund's total return should exceed the return of the median fund in a universe of comparable funds. The risk of the Fund, as measured by the standard deviation of return, should be in the mid-range (25th to 75th percentile) of a universe of comparable funds.

The intermediate-term (three to five year) objective of the Fund is to outperform each of the capital markets in which assets are invested, net of fees. During periods of extreme market volatility, preservation of capital takes a higher precedence than outperformance of the capital markets.

For the Total Fund, a policy benchmark index has been established based on the asset class target exposures described above. The Board approved the following policy in the first quarter of 2006. This index is constructed as follows:

Asset Class	Weight	Benchmark
US Equities	50%	DJ Wilshire 5000 Index
International Equities	15%	MSCI EAFE Index
U.S. Core Fixed Income	20%	Lehman Aggregate
High Yield Fixed Income	5%	Merrill Lynch BB/B High Yield Index
TIPS	5%	BGI Inflation-Linked Bond Index
Private Real Estate	5%	NCREIF Property Index*

The Board approved the following policy in the first quarter of 2009. This index is constructed as follows:

Asset Class	Weight	Benchmark
US Equities	35%	DJ Wilshire 5000 Index
International Equities	20%	MSCI EAFE Index
U.S. Core Fixed Income	15%	Barclays Capital Aggregate
Long Duration Fixed Income	10%	Barclays Capital Long Gov't/Credit*
High Yield Fixed Income	10%	Merrill Lynch BB/B High Yield Index
Private Real Assets	5%	Custom Real Asset Benchmark
Private Real Estate	5%	NCREIF Property Index*

The Board approved the following policy in first quarter 2010, slightly diversifying the International Equity allocation within the portfolio. This index is constructed as follows:

Asset Class	Weight	Benchmark
US Equities	35%	DJ Wilshire 5000 Index
International Equities	14%	MSCI EAFE Index
International Equities	6%	MSCI ACWI ex-US Index
U.S. Core Fixed Income	15%	Barclays Capital Aggregate
Long Duration Fixed Income	10%	Barclays Capital Long Gov't/Credit*
High Yield Fixed Income	10%	Merrill Lynch BB/B High Yield Index
Private Real Assets	5%	Custom Real Asset Benchmark
Private Real Estate	5%	NCREIF Property Index*

*The board will shift its policy index from the pre-existing policy to the new policy as it is implemented.

The following chart details the Maryland-National Capital Park and Planning Commission's consultant, Wilshire Associates, 2010 asset class risk and return assumptions[1]. These assumptions are used as a proxy for the return/risk expectations of each asset class.

Asset Class	Expected Return (%)	Expected Risk (%)
U.S. Equities	7.50	16.00
International Equities (EAFE)	7.75	16.00
U.S. Core Fixed Income	4.25	5.00
Long Duration Fixed Income	5.25	10.00
High Yield Fixed Income	6.00	10.00
Private Real Assets	8.40	10.50
Private Real Estate	7.35	12.25
Total Fund Policy	7.04	10.22

INVESTMENT MANAGER GUIDELINES AND OBJECTIVES

Individual statements of Investment Manager Guidelines and Objectives shall be prepared for each asset class and investment manager type. These statements shall contain investment objectives and risk control provisions, which are appropriate for each investment manager's mission. Taken in the aggregate, these statements shall be designed to implement the overall policies and objectives of the Fund.

In addition to complying with the appropriate Investment Manager Guidelines and Objectives, the role of each investment manager shall include:

a. The exercise of a high degree of professional care, skill, prudence, and diligence in the management of assets under its direction;
b. Thorough professional analysis and judgment with respect to all investments held in the account;
c. Diversification of securities by issuer, industry, geography, type, and maturity of investments, etc.;
d. Full compliance with applicable fiduciary standards and any governmental regulations and decisions dealing with the management and investment of pension funds.

[1] Asset class return and risk assumptions are 'long-term' forecasts that cover at least the next ten years

Specific guidelines that apply broadly to each asset class are as follows:

US Equity Guidelines

- **Asset Allocation** – the US equity composite is expected to be "fully" invested at all times. In recognition of transactional cash, the US equity portfolio managers will be limited to having no more than 5% of the value of the portfolio in cash equivalents at any time.
- **Diversification** – the US equity composite is expected to remain "broadly diversified" by economic sector, industry and individual securities at all time. The composite should match the Russell 3000 Index in terms of capitalization and growth characteristics.
- **Market Capitalization** – both large and small capitalization stocks will be used to implement the US equity strategy. The investment structure of the US equity composite has been developed to mimic the overall profile of the US equity market. In general, 75% to 85% of the US equity composite is expected to be invested "large capitalization stocks" while 15% to 25% is expected to be invested in "small and mid capitalization stocks".

International Equity Guidelines

- **Asset Allocation** – the international equity composite is expected to be "fully" invested at all times. Cash equivalent exposure will be minimized and limited to 5%. Developed markets will be used and emerging market exposure may be used opportunistically to implement the international equity strategy. The investment structure of the international equity composite has been developed to mimic the overall profile of the international equity market. Currently, approximately 80% to 100% of the international equity composite is expected to be invested in "developed markets" while 0% to 20% is expected to be invested in "emerging markets".
- **Diversification** – the international equity composite is expected to remain "broadly diversified" by economic sector, industry and individual securities at all time.

Fixed Income and Treasury Inflation Protected Securities Guidelines

- **Asset Allocation** – the fixed income composite is expected to be "fully" invested at all times. However, unlike equity-oriented allocations, short-term or cash equivalents investments may play an important role in managing a fixed income strategy. Therefore, although the intention is to remain fully invested, the fixed income composite may have up to 20% of its value in cash equivalents at any time.
- **Diversification** – the fixed income composite is expected to be broadly diversified by issuer, sector, quality and maturity (duration) structure. Except for securities issued by the US Government and / or its Agencies, any single issuer is not expected to exceed 5% of the market value of the fixed income composite at any time.
- **Duration / Maturity** – the fixed income composite is expected to remain interest rate neutral relative to the asset class benchmark. Interest rate anticipation is **not** expected to be a meaningful source of return in the fixed income composite. The duration of the fixed income composite is expected to remain within +/- 1.5 years relative to the asset class benchmark. Except for long duration fixed income mandates, securities with a final maturity date greater than 31 years are prohibited.
- **Quality** – the fixed income composite is structured with a strategic exposure to both investment grade and high yield securities. On a combined basis, the fixed income composite is expected to maintain an aggregate rating of at least single A or the equivalent from a recognized rating agency (Standard & Poor's / Moody's).
    - **Opportunistic & Distressed Securities –** The fixed income composite may contain an allocation to opportunistic investments and distressed securities. This allocation will be

drawn from the portfolio's high yield allocation. The objective of this allocation is to provide either return enhancement or diversification that is consistent with the long term strategic objectives of the portfolio. The implementation of this allocation will be limited to those strategies accepted by other large institutional investors with the use of established institutional quality managers.

- **Prohibited Investments:** Build America Bonds (BABs) issued by Montgomery County, Maryland and Prince George's County, Maryland.

Real Estate Guidelines

- **Asset Allocation** – the real estate composite is expected to be "fully" invested at all times. Cash equivalent exposure within the portfolio will be minimized and limited to 10%. Primarily equity-oriented, but investments in debt instruments secured by real estate may also be used to implement the private real estate strategy.
- **Diversification** – the real estate composite is expected to remain "broadly diversified" by geographic region, property type, and individual property investment at all times. The portfolio is expected to be diversified by geographic region and property type with maximum allocations to each of 150% of its weight in the index and a minimum of 50% of its weight in the index. No individual property investment is expected to exceed 7.5% of the real estate composite at any time.

Diversified Real Assets (ex-Real Estate) Guidelines

- **Asset Allocation** – the real assets composite is expected to be "fully" invested at all times. Investments will be structured privately in the form of limited partnerships and diversified among the following investment types: energy, mining, timber, agriculture, and infrastructure.
- **Diversification** – the real assets composite is expected to remain "broadly diversified" by geographic location, vintage year, and individual partnership investment at all times. The portfolio is expected to be diversified by geographic location with the following weightings: United States (65% - 75%), Non-US Developed (15% - 20%), and Non-US Emerging (10% - 15%). The fund will be diversified by vintage year making initial investments during 2010, 2011 and 2012, each being equally weighted at 33% (with a range from 30% to 35%). No single partnership commitment is expected to be more than 20% of the real assets composite, and no single partnership commitment is expected to be more than 20% of the portfolio of a fund-of-funds manager.

Communications and Review

The Board will meet on a regular basis to review investment performance and compliance with these Policies and Guidelines. The Board will also meet with each investment manager at least biennially for these purposes.

In addition to the regular reporting of assets and transactions, each manager shall provide, at least quarterly: (1) a written commentary in sufficient detail such that the Trustees are apprised of account status and any material changes in personnel, philosophy, investment strategy or process, growth, level of commitment to product type or any organizational issues; and (2) a summary of transactions which lists brokers used and commissions generated. Each manager is also directed to contact the Administrator with any information of an important nature that is causing or could cause material impact on the Fund or the investment management organization.

Amendments and Confirmation

This Statement of Investment Policy and the Investment Manager Guidelines and Objectives shall be reviewed periodically by the Board and revised or confirmed, as appropriate.

If, at any time, an investment manager feels that the objectives cannot be met or that the guidelines unduly restrict performance, the Board should be notified in writing. Each manager is encouraged to suggest changes in these policies and guidelines at any time. By initial and continuing acceptance of this Statement of Investment Policy and the specific Manager Guidelines, each manager concurs with the provisions contained therein.

Proxy Voting

The following general policies apply to proxy voting:

1. Investment managers shall vote all proxies in a manner, which is consistent with the best interests of the System and the Fund.
2. Votes involving the issue of share-voting rights will be voted in a manner, which is most in the direction of one share one vote.
3. Where the Board becomes aware of pending proxy issues of particular significance, the Trustees, or their designee, may communicate that information to the responsible investment manager.
4. Managers should be prepared to discuss their proxy voting decisions, if asked, when appearing before the Board.
5. Equity managers are required to have proxy voting policies and shall provide the Board with copies of their policies.

DERIVATIVES POLICY STATEMENT

Objectives

This Derivatives Policy Statement is meant to supplement the Investment Policy Statement. These guidelines identify and allow common derivative investments and strategies, which are consistent with the Investment Policy Statement. The guidelines also require investment managers to follow certain controls, documentation, and risk management procedures.

Definition and Classification of Derivatives

A derivative is a security or contractual agreement that derives its value from some underlying security, commodity, currency, or index. These guidelines classify derivatives into four separate categories distributed across two classes: derivative contracts and derivative securities:

1. Derivative Contracts
   a. Forward-based derivatives, including forward contracts, futures contracts, swaps, and similar instruments.
   b. Option-based derivatives, including put options, call options, interest rate caps and floors, and similar instruments.

2. Derivative Securities
   a. Collateralized Mortgage Obligations (CMOs).
   b. Structured Notes.

Allowed Use of Derivatives

1. Derivative Contracts
   a. Hedging. To the extent that the non-derivative component of a portfolio is exposed to clearly defined risks and derivative contracts exist which can be used to reduce those

risks, the investment managers are permitted to use such derivatives for hedging purposes, including cross-hedging of currency exposures, subject to the documentation requirements below.

b. Creation of Market Exposures. Investment managers are permitted to use derivatives to replicate the risk/return profile of an asset or asset class provided the guidelines for the investment manager allow for such exposures to be created with the underlying assets themselves.

c. Management of Country and Asset Exposure. Manager's charged with tactically changing the exposure of their portfolio to different countries and/or asset classes are permitted to use derivative contracts for this purpose.

2. Derivative Securities

a. "Plain Vanilla" CMOs. For the purpose of this policy, we will define a "plain vanilla" CMO as one which can be shown the CMO is less exposed to interest rate and prepayment risk than the underlying collateral.

b. Other CMOs. CMOs, which are not plain vanilla, are restricted to 5% of a manager's portfolio.

c. Structured Notes. Structured notes may be used so long as the exposure implied by their payment formula would be allowed if created without use of structured notes.

Prohibited Uses of Derivatives

Any use of derivatives not listed above is prohibited without written approval of the Board. Investment managers are encouraged to solicit such approval if they believe the list above is too restrictive. By way of amplification, it is noted that the following two uses of derivatives are prohibited:

1. Leverage. Derivatives shall not be used to magnify exposure to an asset, asset class, interest rate, or any other financial variable beyond that which would be allowed by a portfolio's investment guidelines if derivatives were not used. Any use of leverage is prohibited unless expressly permitted within the investment manager guidelines.

2. Unrelated Speculation. Derivatives shall not be used to create exposures to securities, currencies, indices, or any other financial variable unless such exposures would be allowed by a portfolio's investment guidelines if created with non-derivative securities.

Transaction-Level Risk Control Procedures and Documentation Requirements

For each over-the-counter derivative transaction, except foreign exchange forward contracts, investment managers are required to obtain at least two competitive bids or offers. For small-issue CMOs, it is acceptable to obtain competitive prices on similar securities.

For all derivatives transactions, investment managers should maintain appropriate records to support the derivatives used and employed for allowed strategies. In addition, the following requirements apply to derivative securities:

1. "Plain Vanilla" CMOs. Document the CMO is in fact "plain vanilla", according to the definition in Section 2.a above.

2. Other CMOs. These CMOs must be stress tested to estimate how their value and duration will change with extreme changes in interest rates. An extreme change is one of at least 300 basis points.

3. Structured Notes. Document that note does not create exposures which would not be allowed if created without derivatives.

Portfolio-Level Risk Control Procedures and Documentation Requirements

1. Counterparty Credit Risk. Managers are required to measure and monitor exposure to counterparty credit risk. All counterparties must have commercial paper credit ratings of at least A1 or equivalent rating.

2. Ongoing Monitoring of Risk Exposures. The duration and other risk exposure limits specified in the managers' guidelines are expected to be satisfied on an ongoing basis. Thus, managers must monitor changing risk exposures. Fixed income managers investing in CMOs should pay particular attention to the changing duration of their CMOs, and should anticipate potential changes in duration at the time CMOs are purchased so that interest rate and prepayment rate changes do not inadvertently move the portfolio out of compliance.

3. Valuation of Holdings. The investment managers and custodian shall provide the Board with their pricing policies including a list of sources used. The Board should be notified of any exception to these policies. The custodian is required to obtain prices independent of the manager, or to notify the Board that independent prices are not available. The investment managers are required to reconcile the valuations of all derivatives positions with the custodian not less than monthly.

4. Quarterly Reporting. Each manager using derivatives shall submit within thirty days of the end of each quarter a report with the following information:

   a. A list of all derivative positions as of quarter-end.
   b. An assessment of how the derivatives positions affect the risk exposures of the total portfolio.
   c. An explanation of any significant pricing discrepancies between the manager and custodian bank.
   d. An explanation of any events of non-compliance.
   e. For managers of commingled funds, a list of derivative positions and assessment of the effect on the risk exposure of the portfolio.

Guidelines for use of Pooled Funds Which Employ Derivatives

Mutual funds and other types of commingled investment vehicles provide, under some circumstances, lower costs and better diversification than can be obtained with separately managed funds pursuing the same investment objectives. However, commingled investment funds cannot customize investment policies and guidelines to the specific needs of individual clients. The Board is willing to accept the policies of such funds in order to achieve the lower costs and diversification benefits of commingled funds.

Therefore, commingled investment vehicles are exempt from all policies specified above, except 4.e above if:

1. The investment practices of the commingled fund are consistent with the spirit of this derivatives policy, and are not significantly different in letter.

2. The benefits of using a commingled vehicle rather than a separate account are material.

FAIR CONSIDERATION / PUBLIC INTEREST POLICY

I. It is the policy of the Board that it does ***not*** discriminate against minority owned firms in its manager selection process. The Board desires that Staff and the Investment Consultant identify, research and evaluate qualified minority owned managers. The Board also desires that Investment Managers give consideration to such managers and brokers in their efforts to fulfill the Funds' investment objectives, but only in compliance with their respective fiduciary duties to the Funds.

Minority Managers – Criteria

As used in this Investment Policy, a minority manager shall be defined as an investment manager or broker that is U.S. domiciled and is majority-owned by one, or any combination, of the following groups: African American, Asians (including Pacific Islanders), Native American, Hispanic American, women and physically or mentally disabled individuals.

In addition to the requirements above, any qualified Investment Manager must be a registered investment advisor under the Investment Advisors Act of 1940. Any Broker must be properly licensed.

Measures to Prevent Discrimination in the Selection Process

The process utilized in the selection of Investment Managers is intended to be a competitive, objective process designed to ensure that the Plan has access to a broad array of quality service providers.

To procure investment management services, the administrator, in conjunction with a consultant, often drafts and issues a Request for Proposal ("RFP"). The RFP identifies the services sought, outlines the proposal specifications and selection process, and requests detailed information. The RFP is advertised to ensure that all qualified providers have an opportunity to bid. In addition to the advertisement, the Board's consultant will attempt to identify both minority and majority owned firms that meet the specifications of the mandate and, when appropriate, notify these firms of the outstanding RFP. There may be circumstances in which an RFP is not issued or advertised for an investment mandate. If a search is conducted without the use of an advertised RFP, the consultant will attempt to identify and include minority owned firms that meet the specifications of the mandate within the evaluation process.

Following the collection of RFP responses or initial screening, the consultant will review, consolidate and synthesize the appropriate information into a review document. The Investment Monitoring Group ("IMG") will review the information received. The IMG may interview finalists, undertake site visits, contact references, confirm performance or other data, and conduct such additional due diligence as may be prudent under the circumstances. Upon completion of the initial due diligence, the IMG will present its recommendation to the Board for approval and final consideration. The finalist(s) recommended to the Board will present for final selection.

II. It is also the policy of the Board to encourage the participation of emerging managers in its manager selection process. The Board desires that Staff and the Investment Consultant identify, research and evaluate qualified emerging managers. The Board also desires that Investment Managers give consideration to such managers and brokers in their efforts to fulfill the Funds' investment objectives, but only in compliance with their respective fiduciary duties to the Funds. The Board desires that Staff and the Investment Consultant identify research and evaluate qualified emerging managers.

<u>Emerging Managers – Criteria</u>

As used in this Investment Policy, an emerging manager shall be defined as an investment manager or broker that is U.S. domiciled and

- ♦ must be registered under the Investment Advisors Act of 1940 or be exempt there from (and will maintain such registration or exemption); any broker must be properly licensed
- ♦ must provide transparency of positions and transactions;
- ♦ must provide at least quarterly liquidity;
- ♦ must have a three-year historical, performance record verified by at least one consultant or accounting firm in accordance with Global Investment Performance Standards (GIPS);
- ♦ must have no more than $3.0 billion of total assets under management when hired.

It is the Board's intention to give such firms consideration in their efforts to fulfill the Funds' investment objective; however, the Board is not obligated to hire any qualified manager on behalf of the Funds if such hiring is inconsistent with its fiduciary duty to the Funds and their stakeholders.

In an effort to ensure the inclusion of qualified emerging managers in the process, the IMG will consider at least one such qualifying firm in its final evaluation process (consisting of an in-person presentation of the firm's capabilities). A qualifying firm will still need to meet the minimum stated criteria established in the search process (e.g. assets under management, track record, etc.). The IMG may recommend the Board grant an exception to the requirement to include one qualified emerging manager in the final evaluation process.

<u>Divestment</u>

From time to time the Board may determine that public policy considerations, including financial and reputational risks, warrant divestment from particular companies or regions. Divestment actions may be taken by the Board and memorialized in a resolution that then becomes a part of this Statement of Investment Policy, unless and until rescinded by subsequent action of the Board.

(Revised Statement of Investment Policy and Fair Consideration/Public Interest Policy Approved at the February 1, 2011 Board of Trustees Meeting)