INVESTMENT POLICY STATEMENT

For

The Colorado Public School Fund Investment Board

Fund Description (State Constitution: Article IX, Section 3; CRS 22-41-101/106)

Adopted: June 24, 2019

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Fund Description

(State Constitution: Article IX, Section 3; CRS 22-41-101/106)

The State Public School Fund, d/b/a the Public School Permanent Fund (PSPF), was created under Colo. Const. art. IX, § 3, and CRS 22-41-101, et seq., and consists of a portion of the proceeds from the sale or use of such lands as have been or may be granted to the state by the federal government for state school educational purposes.

The State Treasurer is the custodian of the PSPF. Investments in the fund are directed by The Public School Fund Investment Board (PSFIB), created in 2016 under CRS 22-41-104(2). The PSFIB consists of five members: the State Treasurer, who serves as the Chair of the Board, one member of the State Board of Land Commissioners, and three members appointed by the State Treasurer. The State Treasurer and two other voting members of the PSFIB constitute a quorum of the Board. Except for the State Treasurer, members of the PSFIB serve two-year terms and may not serve more than three consecutive terms. The State Board of Land Commissioners or the State Treasurer may remove their appointed members for any cause that renders the member incapable of discharging or unfit to discharge his or her duty to the PSFIB.

The public purpose for the creation of the PSFIB is to ensure reasonable growth in the PSPF through lawful investments authorized under CRS 24-36-109 (time deposits under 2 years), CRS 24-36-112 (deposits in savings and loan associations under 3 years), CRS 24-36-113 (fixed income securities denominated in United States Dollars), CRS 24-36-111.5 (real property owned by a school district), CRS 22-41-104 (stock mutual funds, index funds, other instruments that are not a direct investment in a corporation, and bonds issued by school districts), and other lawful financial assets as specified in the PSFIB's Investment Policy.

The State Constitution, article IX, § 3, states that this fund shall forever remain inviolate and intact. Interest and income is expended in the maintenance of the schools of the State and distributed amongst the several counties and school districts of the State in accordance with CRS 22-41-102 and related statutory provisions. Except as otherwise provided by law, no part of the PSPF, either principal or interest and income, can be transferred to any other fund or used or appropriated. The State, by appropriation, must supply all losses of principal if not offset by a gain on an exchange or sale in the fund.

Purpose

The purpose of this Investment Policy Statement (IPS) is to assist the PSFIB in effectively supervising, monitoring and evaluating the investments of the PSPF.

The investment program is defined in the various sections of the IPS by:

- Stating in a written document the PSFIB's expectations, objectives and guidelines for the investment of all assets.

- Setting forth an investment structure for managing all assets. This structure includes various asset classes, investment management styles, asset allocation and acceptable ranges that, in total, are expected to produce a sufficient level of overall diversification and total investment return over the long-term.

- Providing guidelines for certain investment portfolios that control the level of overall risk and liquidity assumed in that portfolio, so that the PSPF is managed in accordance with stated objectives. Manager specific guidelines are contained within Appendix I of this IPS.

- Encouraging effective communications among the PSFIB, the Investment Consultant(s), the Investment Managers, State Treasury, State Land Board and other stakeholders.

- Establishing formalized criteria to monitor, evaluate, and compare the performance results achieved by the investment managers on a regular basis.

- Complying with all fiduciary, prudence and due diligence requirements that experienced investment professionals would utilize, and with all applicable laws, rules and regulations from various local, state, and federal political entities that may impact the PSPF's assets.

This IPS has been formulated, based upon consideration by the PSFIB of the financial implications of a wide range of policies, and describes the prudent investment process that the PSFIB deems appropriate. Although the PSFIB seeks to set forth an investment policy that provides broad overarching guidance, this IPS is not designed to be comprehensive as to all investment scenarios that may arise, nor can it account for all contingencies that may impact the PSPF. This IPS is subject to modification or revision at the PSFIB's discretion. The IPS will be reviewed at least annually to ensure it reflects the goals and objectives of the PSPF and the PSFIB.

Investment Objective

The primary investment objective of the PSFIB is to securely invest PSPF assets for the intergenerational benefit of public schools and in a manner that complies with the "Uniform Prudent Investor Act," codified at article 1.1 of title 15 of the Colorado Revised Statutes. Since the PSPF is to remain inviolate and intact, and not subject to appropriation by the General Assembly, the overall objective of the PSFIB is to preserve, protect, and grow the principal of the PSPF with a prudent level of risk over a long term horizon.

Distribution Policy

As per CRS 22-41-102, the order of distribution of interest or income earned on the investment of the moneys in the PSPF is as follows:

- the first $21 million for FY 2017-18, FY 2018-19, FY 2019-20, and every fiscal year thereafter, is credited to the public school fund created by CRS 22-54-114 for distribution as provided by that section;
- an amount annually appropriated by the General Assembly shall be used to pay the expenses of the PSFIB, including but not limited to the services of Investment Managers and consultant(s);
- for FY 2017-18 and FY 2018-19, any interest or income exceeding $21 million plus the PSFIB's expenses, up to $31 million plus the cost of the PSFIB's expenses, is credited to the public school capital construction assistance fund created in CRS 22-43.7-104(5);
- for FY 2019-20, and every fiscal year thereafter, any interest or income exceeding $21 million plus the PSFIB's expenses, up to $41 million plus the cost of the PSFIB's expenses, is credited to the public school capital construction assistance fund created in CRS 22-43.7-104(5); and
- any excess interest or income over $31 million for FY 2017-18 and FY 2018-19, or $41 million for FY 2019-20 and future fiscal years, net of the PSFIB's expenses, is credited as specified by the Colorado General Assembly, taking into consideration the recommendations of the PSFIB. Note there was a recommendation made by the PSFIB under CRS 22-41-102(3)(f)(IV) and (3)(g)(IV) that excess interest or income over these levels be reinvested back into the PSPF. This was approved by the PSFIB at its April 10, 2017 meeting.

Role of the Public School Fund Investment Board (PSFIB)

Under CRS 22-41-102.5(3), the PSFIB shall direct the State Treasurer on how to securely invest moneys deposited in the PSPF for the intergenerational benefit of public schools and in a manner that complies with the "Uniform Prudent Investor Act", codified at article 1.1 of title 15 of the Colorado Revised Statutes. The prudent investor rule is discussed in CRS 15-1.1-101, et seq., and requires trustees and fiduciaries to exercise reasonable care, skill, and caution when considering the purposes, terms, distribution requirements, and other circumstances of a trust, like the PSPF. The PSFIB's investment and management decisions respecting individual assets must be evaluated not in isolation but in the context of the Trust portfolio as a whole and as part of an overall investment strategy having risk and return objectives reasonably suited to a trust such as the PSPF.

The PSFIB considers a number of relevant factors in investing and managing PSPF assets. These include but are not limited to general economic conditions; the possible effects of inflation or deflation; the overall risk of the portfolio; the role that each investment or course of action plays within the overall portfolio; expected interest and income; capital appreciation; liquidity needs; correlation among asset classes and preservation of capital.

Role of the Portfolio Administrator

The Portfolio Administrator will act in coordination with the PSFIB with the overarching goal of ensuring the PSFIB and PSPF are in compliance with their respective legal obligations and investment policy(s). Other duties will include coordinating investment managers, consultant(s), State Treasury, custodian(s), and the PSFIB on matters relating to Board business.

Role of the Consultant

The role of the consultant, as described in more detail in the Statement of Work (Exhibit A) included in their contract, is to support the PSFIB in matters concerning asset allocation, investment structure, manager selection, and performance measurement. The consultant is also expected to keep the PSFIB apprised of developments and trends in the investment management arena.

Role of Investment Managers

The role of investment managers is to manage PSPF assets under their care, custody and/or control in accordance with their respective contracts, the IPS objectives, and guidelines set forth in Appendix I. In doing so it is expected that each investment manager will:

- Exercise investment discretion (including holding cash equivalents as an alternative) within the IPS objectives and guidelines set forth herein.
- Promptly inform the Chair of the PSFIB, the Portfolio Administrator and the Investment Consultant(s) in writing regarding all significant and/or material matters and changes pertaining to the investment of PSPF assets, including, but not limited to:

  A. Investment strategy
  B. Portfolio structure
  C. Tactical approaches
  D. Ownership
  E. Organizational structure
  F. Financial condition
  G. Professional staff
  H. Recommendations for guideline changes
  I. All legal material, SEC and other regulatory agency proceedings affecting the firm.

- Utilize the same care, skill, prudence, and due diligence under the circumstances then prevailing that experienced, investment professionals acting in a like capacity and fully familiar with such matters would use in like activities for similar programs with like aims in accordance and compliance with all applicable laws, rules and regulations from local, state, and federal bodies as it pertains to fiduciary duties and responsibilities.

- Acknowledge and agree in writing annually to their fiduciary responsibility to fully comply with the relevant portions of the IPS as set forth herein, and as modified in the future, as well as guidelines specified in their individual contracts.

- Promptly notify the Chair of the PSFIB, the Portfolio Administrator and the Investment Consultant(s) if they are not in full compliance with the IPS and/or their respective contract or separate account guidelines, and provide plans to move into compliance.

Trades and Exchanges

Investment managers are granted discretionary authority to buy, sell, or exchange securities in the daily management of their individual portfolios. All investment managers will use reasonable efforts to ensure that realized losses are neutralized with realized gains within 12 months of the PSPF’s June 30 fiscal year-end. The PSFIB will review the total portfolio realized and unrealized gain/loss position quarterly to identify opportunities where unrealized gains and losses across all investment advisors/managers may be matched to manage the total portfolio realized gain/loss position.

Liquidity

Sufficient liquidity must be maintained to ensure that all operational requirements are met and that the overall quality and marketability of the portfolio is maintained. Both short-term cash needs and long-term projections will be reviewed on a regular basis to establish an appropriate level of liquidity.

Strategic Asset Allocation

The Strategic Asset Allocation and rebalancing ranges are as follows:

ASSET CLASSES	STRUCTURE	Lower Limit	Strategic Allocation	Upper Limit
Equities:				
	Domestic Equity	8%	12.0%	16%
	International Equity	4%	8.0%	12%
Total Equities		16%	**20.0%**	24%
Fixed Income:				
	Market Duration Bonds	60%	67.5%	75%
	Short Duration Bonds	5%	7.5%	10%
Total Fixed Income		75%	**75.0%**	85%
Diversifying Strategies:				
	Real Estate	0%	5.0%	10%
Total Diversifying Strategies		0%	**5.0%**	10%
Total Portfolio			**100%**	

[1] Asset class level upper and lower limits are based off of the total asset class target allocation, not the sum of parts

The Strategic Asset Allocation may change over time based on the PSFIB's assessment of current and long-term market conditions, and distribution needs. This IPS will be modified accordingly.

The Strategic Asset Allocation is expected to meet the distribution objective of a minimum of $21 million per year, net of annually appropriated investment manager fees and Board expenses and, provide prudent growth in the corpus within the constraints established in state statute.

Rebalancing Guidelines

The asset allocation of the PSPF will be reviewed monthly by the Portfolio Administrator and at least quarterly by the PSFIB. When necessary and/or available, cash inflows/outflows will be deployed in a manner consistent with the strategic recognition of asset class and portfolio net realized gains and losses to move the portfolio closer to the PSPF's Strategic Asset Allocation.

If cash flows are insufficient to bring the PSPF within the Strategic Asset Allocation rebalancing ranges, the Portfolio Administrator, in conjunction with the Investment Consultant(s), State Treasury, and the PSFIB, will evaluate the rebalancing needs, taking into consideration transaction costs and the impact on realized gains and losses.

Asset Class Objectives

Market Duration Fixed Income

The purpose of market duration fixed income is to provide income and diversification to other asset classes in the Fund.

Short Duration Fixed Income

The purpose of the short duration portfolio is to provide capital preservation with a higher yield than cash and a means to manage net realized losses in the overall portfolio.

Equity

The purpose of the equity portfolio is to provide exposure to broad economic growth through commingled exposure to stocks both domestically and abroad. The implementation may be through multiple mutual funds or exchange traded funds as long as the overall composition mirrors the target exposures.

The following security types are prohibited: individual equity securities, funds with insufficient liquidity profiles, and derivatives.

Cash

There is no strategic target allocation to cash. Cash will be held primarily to fund distributions or allocations to existing or new asset classes as needed.

Performance Measurement

Composites and individual portfolios will be measured against appropriate market indices and peer groups, where appropriate.

<u>Total Fund:</u>

Total fund performance will be measured by a static weighted blend of asset class benchmarks reflecting the current Strategic Asset Allocation of 75% Fixed Income and 20% Equities.

<u>Fixed Income Composite</u>

The total fixed income composite will utilize a blended benchmark representing the strategic allocation to sub-asset class strategies – 90% Bloomberg Barclays Aggregate and 10% Bloomberg Barclays 1-3 Year Government/Credit Index.

> <u>Treasury Market Duration Fixed Income Portfolio:</u> Total rate of return performance for the portfolio will be measured against the Bloomberg Barclays U.S. Aggregate Index taking into account statutory constraints prescribed on income distribution and neutralizing realized gains/losses per CRS 22-41-102-104 and the State Constitution,

article IX, § 3. The portfolio will also be measured relative to Callan's Core Bond Peer Group.

Short Duration Fixed Income Composite: Total performance will be measured against the Bloomberg Barclays 1-3 Year Government/Credit Index and Callan's Short Duration Bond Peer Group.

Equity Composite: The equity portfolio will be measured against a blended benchmark comprised of 60% Russell 3000 Index / 40% MSCI ACWI x-US Index. As the portfolio composition is customized, there is no comparable peer group.

Appendix I: Investment Manager Guidelines

A. Colorado State Treasury Managed Market Duration Portfolio

The portfolio may only hold securities eligible for inclusion in the Bloomberg Barclays U.S. Aggregate index at the time of purchase, unless as excepted below in the "Eligible Securities" section.

Maturity/Duration

The portfolio is permitted to invest in fixed income securities across maturities up to 30-years. Decisions on maturity will depend on the current level of interest rates, the shape of the yield curve, economic forecasts, credit fundamentals and spreads. The effective duration of the portfolio shall be normally within +/- 20% of the Bloomberg Barclays U.S. Aggregate Index.

Diversification

Diversification guidelines by sector are shown in the table below:

Sector	Min/Target/Max
U.S. Treasury/Agency/Government Guaranteed/Supranational	0/40/100
Securitized (MBS /CMBS) /ABS	0/30/50
Corporate/Yankees	0/30/50
Taxable Municipals	0/0/10
Cash	0/0/30

Eligible Securities

– *US Treasury/Agency/Government-Guaranteed/Supranational Sector:* Include all Index eligible Global Sovereign, and Government-Related national and supranational entities.

– *Securitized:* Mortgage-backed securities are backed by residential (RMBS) and commercial (CMBS) and collateralized mortgage loan obligations (CMOs)

- CMOs must be backed by GNMA, FNMA or FHLMC collateral.
- The original size of any issue purchased must have been at least $75 million.
- In the case of agency-direct CMO issues whereby the broker/dealer is acting as official agent for Fannie Mae or Freddie Mac and the Trustee is

Fannie Mae or Freddie Mac, there will be no maximum amount constraint per issuer.

- *Asset-Backed Securities (ABS):* ABS securities are backed by consumer loans with under 10 year maturities. The issuing entity trust must be registered in the U.S.
  - The issue must be secured by auto or credit card fixed rate loans, and rated in the highest rating category by one or more nationally recognized rating organizations at the time of purchase.
  - No asset-backed securities with an insurance wrap may be purchased.
  - No asset-backed securities secured by subprime receivables rated less than prime may be purchased.
  - No more than 5% of a single deal will be held. No more than 5% of the portfolio will be held in the securities of a single issuer.

- *Corporate:* Purchases will be limited to Index eligible corporate notes and bonds of U.S. domestic corporations and Yankees.
  - The debt of the issuer must be rated no less than 'BAA3/BBB-' by at least two nationally recognized rating organizations at the time of purchase and in case of split-rated securities, the lower rating will apply.
  - Total holdings of the securities of a given issuer below 'A' to 'BBB-' will be limited to 3% of the portfolio.
  - Total holdings of the securities of a given 'A' rated issuer will be limited to 4% of the portfolio.
  - Total holdings of the securities of a given 'AA' or 'AAA' issuer will be limited to 5% of the portfolio.
  - No more than 5% of the portfolio will be held in the securities of any issuer. No more than 5% of an issue may be held.
  - Yankee Bonds are limited to 5% of the portfolio. Minimum credit rating requirements are the same as those for corporate notes above. (*Yankee bonds are issued by foreign corporations in the U.S., denominated in U.S. dollars, and registered with the Securities & Exchange Commission.)*

- *144A securities are permitted but are limited to those with registration rights subject to a maximum of 10% of the portfolio. No 144A Reg S securities are allowed.*

- *Taxable Municipals:* General (full faith and credit of the issuing entity) and revenue (backed by a specific revenue stream) obligation bonds issued by states, cities, counties, and other governmental entities in the U.S. may be purchased with a rating not lower than A.

B. <u>Externally managed Short Duration Portfolio</u>

The main objective for the management of the Portfolio is to outperform the primary benchmark, the Bloomberg Barclays U.S. 1-3 Year Government/Credit Bond Index, in a risk adjusted manner over a full market cycle.

A custom secondary benchmark, reflecting the ability to allocate to out of benchmark securities, will be composed of 85% Bloomberg Barclays 1-3 Year Government/Credit Index and 15% BofAML 1-3 Year BB US Cash Pay High Yield Index (J1A1).

Guidelines for the portfolio are as follows:

<u>Investment Universe and Limitations</u>: The account managed by Contractor on behalf of PSFIB will invest in corporate bonds and notes; government securities, including agencies; bank loans; mortgage and asset backed securities. The Portfolio may invest in U.S. dollar denominated securities issued by non-U.S. issuers and/or entities, although it intends to primarily invest in securities issued by U.S. issuers and/or entities. Investment types not explicitly allowed in these guidelines may still be used by the Contractor if deemed to be appropriate by Contractor in the exercise of its fiduciary duty to PSFIB. The PSFIB's permission will be sought by Contractor if the investment type is intended to be a primary strategy of the Portfolio, defined as more than 10% of net assets in the Portfolio.

<u>Allowable Investments</u>: The Portfolio managed by Contractor on behalf of PSFIB may include the following (subject to the limitations below):

- Corporate Credits;
- Preferreds;
- 144A securities; excluding 144A Reg S securities
- US Treasuries and Agencies;
- Foreign Government Securities;
- Commercial loans, including bank loans, bridge loans, debtor-in-possession ("DIP") loans, and mezzanine loans; and
- Asset and mortgage backed securities, including, but not limited to commercial mortgage backed securities, collateralized mortgage obligations, collateralized loan obligations and to be announced mortgage backed securities.

<u>General Restrictions</u>: The Portfolio managed by Contractor on behalf of PSFIB shall be subject to the following restrictions:

- The duration of the Portfolio will generally be +25/-40% of the Bloomberg Barclays U.S. 1-3 Year Government/Credit Bond Index.
- The Portfolio will generally not invest more than 10% of its net assets in cash and cash equivalents.

- The maximum issuer position size will be limited to 5% of net assets at the time of purchase, excluding those issued by the U.S. Government and its agencies.
- No more than 10% of the net assets will be invested in preferred securities. The Portfolio will not hold equity securities.
- The Portfolio may invest up to 10% of net assets, at time of purchase, in illiquid securities. 144A securities determined to be liquid by Contractor will not be considered in the illiquid concentration.
- The portfolio may invest up to 25% in non-investment grade bonds with a minimum rating of BB-/Ba3 at the time of purchase. Non-investment grade bonds are defined as bonds that are rated BB+ or lower by Standard & Poor's Rating Service and Fitch Inc., or Ba1 by Moody's Investor Services. Unrated securities will be treated as non-investment grade.
- Split rated securities will be evaluated as follows:
    - i. If the security is rated by all three rating agencies, the middle rating will apply
    - ii. If the security is rated by all three rating agencies with two or more ratings the same, the majority rating applies.
    - iii. If the security is only rated by two agencies, the lowest rating applies.
- Securities that are not rated by any of the three major rating agencies, Standard & Poor's, Moody's, or Fitch, will be considered unrated.

Derivatives: The Portfolio managed by Contractor on behalf of PSFIB may invest in U.S. Treasury futures. The use of derivatives may not result in leverage in the portfolio and must be fully collateralized by cash or cash equivalents.

C. Equity Portfolio

An external investment manager will manage a global equity portfolio for the PSFIB that seeks to adhere to the PSFIB's gain/loss realization requirements with a predicted tracking error within approximately 1% of the composite benchmark. The Portfolio will invest in Exchange Traded Funds ("ETFs") selected for inclusion in the portfolio based upon their contribution to the portfolio's country/region allocation, market capitalization, industry weightings, and other fundamental characteristics.

Benchmark: 60% Russell 3000 Index / 40% MSCI ACWI ex-US Index

Eligible Securities: All US-traded ETFs and '40 Act Mutual Funds, defined to be an "open-end company" as stated in section 5(a)(1) of the Investment Company Act of 1940.
Prohibited Securities: The following security types are prohibited:

- Individual equity securities;
- Funds with insufficient liquidity profiles; and,
- Derivatives (including currency forwards).

Rebalancing: No scheduled rebalancing. The investment manager will review the portfolio with the PSFIB on a quarterly basis in relation to the benchmark and will discuss potential rebalancing trades at that time.

Realized Gain/Loss Off-Set: The day-to-day management of the portfolio will seek to avoid net realized losses over the State Fiscal Year (July 1-June 30). Upon the PSFIB's request, the investment manager may realize gains or losses consistent with the Board's policies. The investment manager will review the portfolio with the PSFIB and/or the Board's Portfolio Administrator on a quarterly basis to discuss current unrealized positions and determine the appropriate levels of gains or losses to be realized, if any.

Treatment of Dividends: Dividends will not be reinvested, unless otherwise instructed by the PSFIB. Available dividends shall be distributed by the custodian to the PSFIB on at least a quarterly basis.