

# Investment Policy Statement

## **CARMEL AREA WASTEWATER DISTRICT**

### **DEFINED BENEFIT PLAN**

**April 2021**



## **EXECUTIVE SUMMARY**

Client Name: Carmel Area Wastewater District  
Client Type: Defined Benefit Plan  
Fiduciary Standard of Care: ERISA  
Tax Id: 94-6000209  
Current Assets: \$6,564,776.36 (as of 4/19/2021)

This Investment Policy Statement should be reviewed by an attorney knowledgeable in this specific area of the law. Any change to this policy should be communicated in writing and on a timely basis to all interested parties. If any term or condition of this Investment Policy Statement conflicts with any trust and/or plan document, that document shall control, as long as such term or condition is consistent with the law.

## **PURPOSE**

The purpose of this Investment Policy Statement (IPS) is to assist the Investment Committee (Committee) and the Investment Manager in effectively supervising, monitoring and evaluating the investment of the District's Retirement Plan (Plan) assets. The Plan's investment program is defined in the various sections of this IPS by:

1. Stating in a written document the Committee's attitudes, expectations, objectives and guidelines for the investment of all of the Plan's assets.
2. Encouraging effective communications between the Committee and all parties involved with the investment management decisions.
3. Establishing formal criteria to select, monitor, evaluate and compare the performance results achieved by each investment option on a regular basis.
4. Setting forth an investment structure for managing the Plan's assets. This structure includes various asset classes, investment management styles, asset allocation and acceptable ranges that, in total, are expected to produce an appropriate level of overall diversification and total investment return over the investment time horizon.
5. Providing guidelines for each investment portfolio that control the level of overall risk and liquidity assumed in that portfolio, so all Plan assets are managed in accordance with stated objectives.
6. Providing rate-of-return and risk characteristics for each asset class represented by various investment options.
7. Complying with all ERISA, fiduciary, prudence and due diligence requirements experienced investment professionals would utilize, and with all applicable laws, rules and regulations from various local, state, federal and international political entities that may impact the Plan assets.

## **STATEMENT OF OBJECTIVES**

The Plan is a defined benefit plan established on 7/1/1969. The Plan currently has \$6,564,776.36 in assets.

This IPS has been arrived at upon consideration by the Committee by a wide range of policies, and describes the prudent investment process the Committee deems appropriate. This process includes offering various asset classes and investment management styles that, in total, are expected to offer the opportunity to diversify the portfolio in a manner consistent with the specified risk and return requirements of the portfolio.

### **The objectives of the Plan are:**

- Have the ability to pay all benefit and expense obligations when due.
- Control costs of administering the Plan and managing the investments.
- Maximize return within reasonable and prudent levels of risk in order to minimize contributions.
- Follow general "safe harbor" rules:
  - i. Retain prudent expert (ERISA 3(38) Investment Manager) to make the all investment decisions as they relate to the management of the Portfolio.
  - ii. Demonstrate that the prudent expert was selected by following a due diligence process.
  - iii. Have the prudent expert acknowledge in writing their fiduciary status
  - iv. Monitor the activities of the prudent expert to ensure that the expert is performing the agreed upon tasks.
    - Seek to maintain a "funding cushion" for unexpected developments and for possible future increases in benefit structure and expense levels.
    - Seek to maintain flexibility in determining the future level of contributions. Investment results are the critical element in achieving the investment objectives, while reliance on contributions is a secondary element.
    - Seek to maintain a fully funded status with regard to current pension liabilities.

### **Time Horizon**

The investment guidelines are based upon an investment horizon of greater than five years. The Plan's strategic asset allocation is also based on this long-term perspective. Short-term liquidity requirements are anticipated to be non-existent, or at least should be covered by the annual contribution.

### **Risk Tolerances**

The Committee recognizes that some risk must be assumed in order to achieve the investment objectives of the Plan. In establishing the risk tolerances of the IPS, the ability to withstand short and intermediate term variability will be considered.

The Plan's long time horizon, current financial condition and several other factors suggest collectively some interim fluctuations in market value and rates of return may be tolerated in order to achieve the longer-term objectives.

### **Performance Expectations**

The desired investment objective is a long-term rate of return on assets that is commensurate with the risk taken. Accordingly, relative performance benchmarks for the investment options are set forth in the "Monitoring" section.

## **DUTIES AND RESPONSIBILITIES**

### **Investment Committee**

As fiduciaries under the Plan, the primary responsibilities of the Committee are:

1. Review this investment policy statement on an annual basis
2. Monitor the activities of the Investment Manager to ensure:
  - Investments are prudently diversified the Plan's assets to meet an agreed upon risk/return profile.
  - Investment are prudently selected in accordance with the Plan's Investment Policy Statement
  - Monitor and supervise all services provided by the Investment Manager
3. Control and account for all investment, record keeping and administrative expenses associated with the Plan.
4. Avoid prohibited transactions and conflicts of interest.

### **Custodian**

Custodians are responsible for the safekeeping of the Plan's assets. The specific duties and responsibilities of the custodian are:

1. Value the holdings.

2. Collect all income and dividends owed to the Plan.
3. Settle all transactions (buy-sell orders).
4. Provide monthly reports that detail transactions, cash flows, securities held and their current value, and change in value of each security and the overall Plan since the previous report.
5. Maintain separate accounts by legal registration.

### **Investment Manager**

The Investment Manager serves as an objective, third-party professional retained to manage the overall investment process, to specifically include the selection, monitoring and replacement (as needed) of portfolio holdings. The Investment Manager is responsible for performing a disciplined and rigorous investment process to enable the Committee to meet the fiduciary responsibilities outlined above. The Investment Manager, as an ERISA 3(38), is a named fiduciary of the Plan.

It is the responsibility of the Investment Manager to prepare and maintain this IPS on an on-going basis, and review it with the Committee on an annual basis.

## **INVESTMENT GUIDELINES**

### **Asset Class Guidelines**

The Committee believes long-term investment performance, in large part, is primarily a function of asset class mix. Historically while interest-generating investments, such as bonds, have the advantage of relative stability of principal value, they provide little opportunity for real long-term capital growth due to their susceptibility to inflation.

On the other hand, equity investments, such as common stocks, clearly have a significantly higher expected return but have the disadvantage of much greater year-by-year variability of return. From an investment decision-making point of view, this year-by-year variability may be worth accepting given the Plan's long time horizon.

Focusing on balancing the risks and rewards of each broad asset class, the following implementation peer groups were selected and ranked in ascending order of "risk" (least to most) according to the most recent quarter's median 3-year Standard Deviation values.

Money Market Taxable  
Ultra Short-Term Bonds  
Short-Term Bond  
Intermediate-Term Bond  
Mortgage Backed Securities  
Long-Term Bond  
Inflation Protected Bonds  
Bank Loan  
High Yield Bonds

Large Growth  
 Large Blend  
 Large Value  
 Mid-Cap Growth  
 Mid-Cap Blend  
 Mid-Cap Value  
 Small Growth  
 Small Blend  
 Small Value  
 Foreign Large Cap  
 Diversified Emerging Markets  
 Sectors  
 Alternatives

### **Rebalancing of Tactical/Strategic Allocation**

The percentage allocation to each peer group may vary depending upon market conditions. Please reference the allocation table below for the lower and upper limits for each peer group. When necessary and/or available, cash inflows/outflows will be deployed in a manner consistent with the strategic asset allocation and allocation ranges of the Plan. If there are no cash flows, the allocation of the Plan will be reviewed quarterly. If the Investment Manager judges cash flows to be insufficient to bring the Plan within the target allocation ranges, the Investment Manager shall decide whether to effect transactions to bring the allocation of Plan assets within the threshold ranges.

<b>Asset Class</b>	<b>Lower Limit</b>	<b>Upper Limit</b>
Money Market Taxable	0%	100%
Ultra Short-Term Bond	0%	50%
Short-Term Bond	0%	50%
Intermediate-Term Bond	0%	60%
Mortgage Backed Securities	0%	30%
Long-Term Bond	0%	40%
Inflation Protected Bonds	0%	20%
High Yield Bonds	0%	20%
Bank Loan	0%	20%
Large Growth	0%	45%
Large Blend	0%	45%
Large Value	0%	30%
Mid-Cap Growth	0%	15%
Mid-Cap Blend	0%	15%
Mid-Cap Value	0%	15%
Foreign Large Cap	0%	20%
Small Growth	0%	15%
Small Blend	0%	15%
Small Value	0%	15%
Diversified Emerging Markets	0%	15%
Sectors	0%	15%
Alternatives	0%	15%

## **IMPLEMENTATION**

Each investment option should be managed by: (i) a bank; (ii) an insurance company; (iii) a registered investment company (mutual fund); or, (iiii) a registered investment advisor. The Investment Manager will apply the following due diligence criteria in selecting each money manager or mutual fund.

### **Quantitative Factors – 83.3% of Total**

#### **Style Related – 16.7% of Total**

- 5-Year Consistency: 1 point if the style consistency is less than 29
  - When selecting an investment, you want to know that it has provided a relatively “true” exposure to the category in which it falls.
  - A 5-year style consistency score of less than 29 implies that the divergence of an investment portfolio from its stated investment style or objective as measured by the consistency from the Morningstar category is minimal.
- 5-Year R<sup>2</sup>: 1 point if the R<sup>2</sup> is at least 80%
  - When selecting an investment, you want to know how correlated the investment’s returns are with its benchmark index.
  - This value of R<sup>2</sup> implies that the investment’s return moves in the same direction as the index 80% or more of the same.

#### **Return Based – 33.3% of Total**

- 1-Year Return: 1 point if the investment outperformed the peer group median.
- 3-Year Return: 1 point if the investment outperformed the peer group median.
- 5-Year Return: 1 point if the investment outperformed the peer group median.
  - When selecting an investment, you want to know that it has demonstrated an ability to outperform relative to its peers.
  - A total return greater than the peer group median implies that the investment has outperformed more than half of other investments in its same category.
  - The investment can potentially receive 1 point for each time period: 1-, 3-, and 5-years.

- 5-Year Up Capture/Down Capture: 1 point if this ratio is greater than 1.
  - When selecting an investment, you want to know that it “captures” more than 100% of market returns in up markets and helps “cushion” the loss in down markets by capturing less than 100% of the fall.
  - A ratio of greater than 1 implies that the investment captures more when the market is up than when it is down.

### **Risk Based – 33.3% of Total**

- 3-Year Information Ratio: 1 point if the ratio is greater than 0.
- 5-Year Information Ratio: 1 point if the ratio is greater than 0.
  - When selecting an investment, you want to know how its returns compare to the index and to the amount of risk it took to generate those returns.
  - An Information Ratio greater than 0 implies that the investment outperformed its benchmark index.
- 3-Year Beta: 1 point if the beta is between 0.75 and 1.15.
- 5-Year Beta: 1 point if the beta is between 0.75 and 1.15.
  - When selecting an investment, you want to know how much risk the manager takes on relative to their benchmark index. You want managers to take some risk – as you need to take some risk to generate decent returns – but, not so much risk that it is egregious.
  - A Beta of 1 means that the manager is taking on the same level of risk as the benchmark index.
  - A Beta between 0.75 and 1.15 implies that the manager is taking on risk that is between 75% and 115% of the benchmark index.

### **Qualitative Factors – 16.7% of Total**

#### **Expense Ratio – 8.4% of Total**

- Net Expense Ratio: 1 point if the ratio is less than or equal to the category average.
  - When selecting an investment, you want to know how much it costs as total fees reduce the total return captured by the investor.



- An expense ratio less than the category average implies that the fund charges no more than the average of all others that fall into the same category.

### **Manager Tenure – 8.4% of Total**

- Longest Tenured Manager: 1 point if the tenure of the longest tenured manager is greater than the category average.
  - When selecting an investment, you want to know that the track record being reviewed is primarily one from the current management team.
  - A tenure greater than the category average implies that the manager has been on the investment team for a relatively long period of time.

## **MONITORING**

### **Monitoring - Performance Objectives**

The Committee acknowledges fluctuating rates of return characterize the securities markets, particularly during short-term time periods. Recognizing that short-term fluctuations may cause variations in performance, the Committee intends to evaluate investment performance from a long-term perspective.

The Committee is aware the ongoing review and analysis of the investment options is just as important as the due diligence process. The performance of the investment options will be monitored on an ongoing basis and it is at the Investment Manager's discretion to take corrective action by replacing a mutual fund/ETF manager if they deem it appropriate at any time.

On a timely basis, but not less than quarterly, the Committee will meet to review each investment, specifically:

1. The investment option's adherence to the Watch List Criteria identified below;
2. Material changes in the investment option's organization, investment philosophy and/or personnel; and,
3. Any legal, SEC and/or other regulatory agency proceedings affecting the investment option's organization.

### **Monitoring - Benchmarks**

The Committee has determined it is in the best interest of the Plan's participants that performance benchmarks be established for each investment option. Mutual fund/ETF manager performance will be evaluated in terms of an appropriate market index (e.g. the S&P 500 stock index for large-cap domestic equity manager) and the relevant peer group (e.g. the large-cap growth mutual fund universe for a large-cap growth mutual fund).

**Asset Class**

Money Market Taxable  
Ultra Short-Term Bond  
Short-Term Bond  
Intermediate-Term Bond  
Mortgage Backed Securities  
Long-Term Bond  
Inflation Protected Bonds  
High Yield Bonds  
Bank Loan  
Large Growth  
Large Blend  
Large Value  
Mid-Cap Growth  
Mid-Cap Blend  
Mid-Cap Value  
Small Growth  
Small Blend  
Small Value  
Foreign Large Cap  
Diversified Emerging Markets  
Sectors  
Alternatives

**Benchmark Index**

USTREAS T-Bill Auction Ave 3 Mon  
USTREAS T-Bill Auction Ave 3 Mon  
USTREAS T-Bill Auction Ave 3 Mon  
BarCap US Govt/Credit 5-10 Yr TR USD  
BarCAP US MBS TR  
BarCap US Govt  
BarCap US Treasury TIPS  
BarCap US Corporate High Yield  
BarCap US Govt  
Russell 1000 Growth TR USD  
Russell 1000 TR USD  
Russell 1000 Value TR USD  
Russell Mid Cap Growth TR USD  
Russell Mid Cap TR USD  
Russell Mid Cap Value TR USD  
Russell 2000 Growth TR USD  
Russell 2000 TR USD  
Russell 2000 Value TR USD  
MSCI AC World Ex USA NR USD  
MSCI AC EM Ex USA NR USD  
Applicable Sector Index  
Applicable Alternative Index

**Monitoring - Watch List Criteria**

The decision to retain or terminate an investment option cannot be made by a formula. Also, extraordinary events do occur that may interfere with the investment option's ability to prudently manage investment assets. It is the Investment Manager's confidence in the investment option's ability to perform in the future that ultimately determines the retention of an investment option.

An investment option may be placed on a Watch List and a thorough review and analysis of the investment option may be conducted.

**Investment Option Termination**

The Investment Manager may give consideration to terminating an investment option if:

- The option significantly underperforms without a justifiable rationale;
- The option fails to achieve performance and risk objectives;
- The option fails to maintain a consistent investment style; or
- The option has been on the "Watch List" for four consecutive quarters.

There are no hard and fast rules for investment option termination. The ultimate decision to retain or terminate an investment option cannot be made by a formula, i.e., changes in market conditions requiring changes in investment options and/or portfolio allocation.

However, the Investment Manager may consider the investment option's anticipated ability to perform in the future when determining whether to retain an investment option.

In addition to those above, other factors may include manager turnover, legal or regulatory proceedings, or material change to investment processes. Of course, the Investment Manager also may remove any investment option at any time and for whatever reason they deem appropriate, including a determination that the investment is no longer suitable for the Participants.

For an investment option to be terminated, one of the following approaches may be taken:

- Remove and replace (map assets) to an alternative investment option;
- Freeze the investment option, but add a competing investment option for new contributions; or
- Remove the investment option and do not provide a replacement investment option.

The guidelines in this IPS are to assist, but not bind, the Investment Manager. In that regard, the Investment Manager should exercise discretion and considered judgment in the termination and replacement process. It is the intention of the Investment Manager to maintain written records of decisions relating to the decision of retaining or terminating an investment option.

### **Monitoring - Expenses**

The Committee will review at least annually all costs associated with the management of the Plan, including:

1. Expense ratios of each mutual fund against the appropriate peer group;
2. Administrative Fees, costs to administer the Plan, including record keeping, custody and trust services; and
3. The proper identification and accounting of all parties receiving soft dollars and/or 12b-1 fees generated by the Plan.

### **INVESTMENT POLICY REVIEW**

The Committee will review this IPS at least annually to determine whether stated investment objectives are still relevant and the continued feasibility of achieving the same. It is not expected that the IPS will change frequently. In particular, short-term changes in the financial markets should not require adjustments to the IPS.

If any term or condition of this IPS conflicts with the Plan, the terms and conditions of the Plan shall control.

The Plan Fiduciaries have reviewed the IPS and agree that the IPS accurately reflects the intent of the Plan Fiduciaries with regard to the range of investments, objectives and criteria for selection, and evaluation of investment options within the Plan.

Date adopted: \_\_\_\_\_

Adopted by Plan Fiduciary:

Print Name: \_\_\_\_\_ Sign Name: \_\_\_\_\_

Print Name: \_\_\_\_\_ Sign Name: \_\_\_\_\_

Print Name: \_\_\_\_\_ Sign Name: \_\_\_\_\_

Print Name: \_\_\_\_\_ Sign Name: \_\_\_\_\_