**The State of New York Deferred Compensation Board**
**Stable Income Fund**

# INVESTMENT POLICIES AND GUIDELINES

**December 13, 2013**

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## I. INVESTMENT OBJECTIVES

The primary investment objective of the Stable Income Fund ("Fund") is preservation of principal. The Fund will also seek to achieve a reasonably stable quarterly return, a high level of liquidity for participant withdrawals and a total return which, over time, exceeds the Fund's Benchmark: the Rolling Yield of the 5-Year Constant Maturity Treasury ("CMT").

## II. INVESTMENT STRATEGY

The Fund seeks to achieve its investment objective through a portfolio consisting primarily of stable value products, as described in these Investment Policies and Guidelines (the "Overall Investment Policy"). Dwight Asset Management Company LLC, the provider of the Fund's Stable Value Structure Management Services ("Dwight"), shall be responsible for the Fund's duration management, liquidity, Guaranteed Investment Contract ("GIC") placements, management of Wrap Contract Sub-Manager and Separate Account portfolio allocations and such other responsibilities and duties as set forth in this Overall Investment Policy and the Stable Income Fund Structure Management Agreement ("Agreement"). Capitalized terms used herein which are not otherwise defined shall have the meaning given to such terms in the Agreement.

### A. Permitted Investments

As assets become available for reinvestment, the Fund's assets may be reinvested in the Stable Value Sectors listed below:

(1) Cash or Cash Equivalents. Cash/cash equivalent investments consist of short-term collective investment funds ("STIFs"), money market funds or other high-quality, cash equivalent investments managed by the Sub-Manager of the Cash Portfolio in accordance with the Sector Guidelines set forth in Section III.

(2) Units of Stable Value collective investment trusts ("CITs") as described below in "Summary Description of Stable Value Sectors" not otherwise included in (4) below which provide book value accounting as part of the CIT structure. Each of the foregoing investments shall have a minimum average credit rating of "AA-" at the time of purchase.

(3) GICs as described under "Summary Description of Stable Value Sectors" below.

(4) Separate Accounts as described under "Summary Description of Stable Value Sectors" below.

(5) Wrapped Fixed Income investments (also referred to as "Synthetic GICs"), as described below in "Summary Description of Stable Value Sectors", wrapping fixed income securities within the limitations set forth in the Fixed Income Sector Investment Guidelines

## B. Fund Diversification

As assets become available for reinvestment, the Fund’s assets will be allocated by Dwight according to the Stable Value Sector guidelines as follows:

| Allocation Guidelines for Stable Income Fund | |
|---|---|
| **Stable Value Sector** | **Permissible Range** |
| Cash/Cash Equivalents | 0-50% |
| Stable Value CIT | 0-5% |
| GICs | 0-20% |
| Separate Accounts | 0-90% |
| Wrapped Fixed Income/Synthetic GICs | 25-95% |

In managing and monitoring the Fund’s allocations within the above Allocation Guidelines, Dwight will assess the Fund’s duration, the Fund’s immediate and anticipated liquidity needs, the terms of the investment contracts, the Fund’s long-term objectives, the performance of the various Sub-Managers and Separate Accounts and such other factors that Dwight deems prudent. In the event that the Fund’s allocation is outside the Allocation Guidelines, Dwight will notify the Board in writing, and will reallocate the Fund’s assets to the above Allocation Guidelines within 10 Business Days, absent approval by the Board of a longer time period or a delay in effecting transactions on the part of one or more Sub-Managers.

## C. Summary Description of Stable Value Sectors

(1) **Wrapped Fixed Income**. The Wrapped Fixed Income component may consist of a portfolio or portfolios of fixed income securities and one or more Wrap Contracts to provide book value liquidity with respect to fixed income portfolios for Plan benefit payments. All Wrap Contract issuers shall be on Dwight's approved wrap issuer list at the time of placement. In addition to individual securities holdings, this component may consist of actively managed portfolios of fixed income securities subject to a sub-advisory agreement with a Sub-Manager, units of CITs, or shares of mutual funds.

(2) **Stable Value Collective Investment Trusts**. The Stable Value CIT component shall consist of collective investment trusts with similar objectives as set forth herein. Fund assets may be invested in units of Stable Value CITs.

(3) **GICs**. The GICs component will generally consist of investment contracts backed by the general account assets of qualified insurance companies or major money center banks or other financial institutions. Dwight will restrict new investments in GICs to those issuers included on Dwight’s approved list, with a limit of 5% of the Fund’s assets in any one issuer, measured at the time of purchase. Dwight will

provide the Board with a description of Dwight's approved list, as amended from time to time.

(4) **Separate Accounts.** Separate Accounts will consist of separate account contracts with insurance companies on Dwight's approved list of issuers under which (i) the assets contributed by the Fund are invested within the limits set forth in Fixed Income Sector Investment Guidelines, (ii) the insurance company provides coverage for book value accounting, and (iii) the assets contributed by the Fund are segregated from the general assets of the insurance company, or any other similar product.

(5) **Cash or Cash Equivalents**. The Cash/Cash Equivalents component is described in the Cash Portfolio Investment Guidelines in Section III hereof.

## D. Deviations

Deviations from the diversification requirements set forth in sections B and C above are acceptable if at the time of the investment it is known that such deviation will occur and is mutually agreed to in writing by Dwight and the Board.

## E. Fund Duration

The duration target of the Fund shall be 3.0 years, with a permissible range of 1.5 years to 4.0 years. Dwight will manage the Fund duration through the allocations to the various Stable Value Sectors and Sub-Managers. The Sub-Manager allocations will be adjusted as necessary based on the actual durations of the respective Sub-Managers' portfolios.

## III. SECTOR GUIDELINES

### A. Cash Portfolio Investment Guidelines

(1) **Investment Objectives**. The Cash Manager will seek to provide liquidity required to meet the cash needs of the Stable Income Fund on a daily basis.

(2) **Approved Investments**. Any of the following fixed income securities, subject to credit and diversification guidelines below, may be held:

(a) Short-term investments eligible for Rule 2a-7 money market funds; STIFs utilized by the custodian or trustee and Rule 2a-7 money market funds;

(b) Instruments issued or fully guaranteed by the U.S. Government, federal agencies, sponsored agencies or sponsored corporations;

(c) Securities issued by supranational entities or sovereign credits.

(d) Residential or commercial mortgage-backed securities, asset-backed securities, structured notes and other similar fixed income investments;

(e) Corporate obligations;

(f) Commercial paper or master notes;

(g) Rule 144A securities;

(h) Certificates of Deposit (includes Domestic, Yankee and Eurodollar issuers), Funding Agreements and Promissory Notes;

(i) Repurchase agreements. Repurchase agreements must be collateralized to the extent of at least 102% of the value lent by U.S. treasuries, agencies, corporate bonds, residential or commercial mortgage-backed securities, residential or commercial whole loans, international sovereign or supranational bonds and senior secured bank loans; and

(j) Municipal obligations (excluding auction rate securities), municipal variable rate demand notes ("VRDN") including non-rated floaters.

(3) **Prohibited Investments**

(a) Equities and securities that derive their price from equities.

(b) Mortgage derivatives such as IOs, POs and inverse IOs.

(c) Securities not expressly covered under Approved Investments outlined above.

(d) Transactions that would be prohibited by ERISA, if ERISA applied to the Plan, and any other applicable law.

(e) Securities and investment techniques used solely for leverage purposes.

(f) Securities issued or guaranteed by the Cash-Manager(s) or its affiliates.

(g) Currencies or currency forwards.

(h) Securities issued by an entity that would be prohibited by the New York State Deferred Compensation Board Iran Investment Policy.

(4) **Diversification Limits**. The following concentration guidelines will be applicable:

| | **Sector Limit** | **Issuer Limit** | **Maturity Limit** |
|---|---|---|---|
| U.S. Treasury | 100% | 100% | 25 months |
| U.S. Government Agency and related entities | 100% | 33% | 25 months |
| Supranational or Sovereigns | 10% | 5% | 25 months |
| Commercial Paper | 75% | 5% | 397 days |
| Certificates of Deposit | 50% | 3% | 397 days |
| Corporate Obligations | 35% | 3% | 25 months |
| Structured Securities described in II(d) | 10% | 5% | 25 months |
| Promissory Notes | 10% | 5% | 95 days |
| Master Notes | 10% | 5% | 1 Year; 90-day put |
| Funding Agreements | 10% | 5% | 1 Year; 90-day put |
| Municipal Obligations | 10% | 5% | 1 Year |
| Money Market Funds (FedFund & Temp Fund) | 100% | 25% | 90 days |
| Repurchase Agreements (Deliverable or Tri Party) | 100% | 25% per counterparty | 90 days |

Rule 144 A securities will be limited to applicable sector, issuer and maturity limits shown in the above table.

(5) **Credit Quality Guidelines (at the time of purchase)**. The Cash Portfolio may invest in securities with:

a) Short-term rating of at least A-1 or A-2 by Standard & Poor's Corporation ("***S&P***") or P-1 or P-2 by Moody's Investors Service ("***Moody's***"), provided that the Cash Portfolio assets rated A-2 and P-2 at time of purchase shall not exceed 10% of the Cash Portfolio. In the event of a split rating, the higher rating will determine the credit quality.

b) Long-term rating of at least A by S&P or A2 by Moody's. In the event of a split rating, the higher rating will determine the credit quality.

c) In the event that an issue is rated both short-term and long-term, the higher rating will determine the credit quality.

d) For municipal obligations (with a short-term rating), the minimum rating must by SP-1 by S&P or MIG 1/VMIG 1 by Moody's.

   o If the Cash Manager is relying on credit enhancement (i.e. letter of credit or monoline insurance) in determining the suitability of a municipal obligation for the Cash Portfolio, such security, with the exception of VRDN's, must have a rating, excluding the credit enhancement, of at least A by S&P or A2 by Moody's.

   o In the case of VRDN's, if the Cash Manager is relying on an irrevocable letter of credit in determining the suitability of such investment for the Cash Portfolio, such security does not need to be rated or may have a rating lower than A by S&P or A2 by Moody's, provided, however, that the letter of credit provider must be rated at least A by S&P or A2 by Moody's.

e) Supranational entities or sovereign credits must have a long-term rating of AAA by S&P or Aaa by Moody's, or a short-term rating of at least A-1 or P-1.

f) Residential or commercial mortgage-backed securities, asset-backed securities, structured notes and other similar fixed income investments must have a long-term rating of AAA by S&P or Aaa by Moody's.

g) If the issue or security has no ratings, the ratings of the underlying program or issuer can be used.

h) Repurchase agreements issued or otherwise backed by dealers must be rated A-1 or P-1 or better by S&P or Moody's.

(6) **Duration**. The duration of Cash Portfolio security holdings shall be 90 days or less.

Securities with discrete maturity dates (Expected final maturity dates) shall be limited to 25 months and for amortizing securities weighted average life will be used to determine maturity at time of purchase. Amortizing securities with legal final maturities past 25 months shall be limited to 5% of the portfolio. To avoid extension risk the maximum legal final maturity for amortizing securities shall be 5 years from trade date.

(7) **Currency Exposure**. Non-U.S. dollar denominated securities are not permitted in the Cash Portfolio.

## B. Fixed Income Sector Investment Guidelines

**Investment guidelines under Wrap Contracts and Separate Accounts shall fit within the limitations set below.**

(1) **Investment Objectives**. The Sub-Manager(s) and Separate Accounts will seek to provide returns that exceed the assigned bond market index. The Sub-Manager(s) will seek to maximize long term total return while controlling and restricting overall portfolio risk.

(2) **Approved Investments**. Any of the following U.S. Dollar denominated fixed income securities subject to credit and diversification guidelines below may be held:

(a) Instruments issued or fully guaranteed by the U.S. Government, federal agencies, sponsored agencies or sponsored corporations;

(b) Securities issued by supranational entities or sovereign credits;

(c) Residential and commercial mortgage-backed securities, corporate bonds, asset-backed securities (including CMOs), structured notes and other similar fixed income investments;

(d) Commercial paper and master notes issued or otherwise backed by an entity rated A1/P1 or better;

(e) Repurchase agreements issued or otherwise backed by dealers rated A-1 and P-1 or better (or less than A-1 and P-1 whose transaction has been guaranteed by an Aaa/AAA rated monoline reinsurer. Repurchase agreements must be collateralized to the extent of at least 100% of the value lent by U.S. treasuries, agencies, corporate bonds, residential and commercial mortgage-backed securities, residential and commercial whole loans, international sovereign and supranational bonds and senior secured bank loans;

(f) Obligations issued or guaranteed by state and municipal governments and agencies;

(g) Securities offered pursuant to Rule 144A, Section 3(a), Regulation S;

(h) Forward Commitments: Securities generally will be purchased and sold on a "regular settlement" basis, with the exception of (i) any eligible new issues which will be purchased for the first available settlement date, and (ii) U. S. Treasury and mortgage-backed securities, which may be purchased on a forward basis not to exceed 180 days;

(i) Pooled or commingled vehicles comprised of permitted investments and managed by the Sub-Manager(s) or investment managers designated by the issuer of Separate Accounts including their affiliates; however, steps will be taken by the Sub-Manager(s) or issuers of Separate Accounts to assure that double fees shall not be charged; and

(j) Futures, options, and swaps.

(3) **Prohibited Investments**

(a) Equities and securities that derive their price from equities.

(b) Mortgage derivatives such as IOs, POs and inverse IOs.

(c) CLOs, CDOs, and CBOs.

(d) Securities not expressly covered under Approved Investments outlined above.

(e) Transactions that would be prohibited by ERISA, if ERISA applied to the Plan, and any other applicable law.

(f) Securities and investment techniques used solely for leverage purposes. For purposes of this section, "leverage purposes" means the use of securities or investment techniques for other than hedging purposes.

(g) Securities issued or guaranteed by the Sub-Manager(s), issuers of Separate Accounts or their affiliates.

(h) Currencies.

(i) Non-U.S. Dollar denominated securities.

(j) Derivatives of any kind shall not be used to leverage the portfolio.

(k) Emerging markets as defined by the Barclays Capital Global Emerging Markets Index.

(l) Securities issued by an entity that would be prohibited by the New York State Deferred Compensation Board Iran Investment Policy.

(4) **Sector Diversification Limits**. The following concentration guidelines will be applicable:

**Concentration Guidelines:**

| Sector | Sector Maximum | Issuer Maximum | Issue Maximum |
|---|---|---|---|
| **Treasuries, Agencies** | 100% | N/A | 15% |
| **Residential MBS** | 50% | | |
| Agency | 50% | N/A | 10% |
| Non-Agency | 10% | 5% | 3% |
| **Commercial MBS** | 15% | 5% | 3% |
| **ABS** | 20% | 5% | 3% |
| **Corporates** | 40% | 5% | 3% |
| **Municipals** | 10% | 5% | 3% |
| **Sovereign, Supranational** | 10% | 5% | 3% |
| **Cash Equivalents** | 40% | 10% | 3% |

The sector limits for Cash Equivalents exclude STIF.

The issuer of any non-agency MBS, Commercial MBS, or ABS security will be the trust that holds the associated collateral and the issuer limits will apply to securities that have claims against any one such trust.

(5) **Credit Quality Guidelines (at the time of purchase)**. Securities must be rated at least BBB-/Baa3 by Moody's, S&P and/or Fitch. .The weighted average portfolio quality on each day will be rated at least Aa3 by Moody's, AA- by S&P and/or AA- by Fitch.

In the case of split-rated securities, the Sub-Manager(s) and Separate Accounts will use the middle rating to determine compliance with quality guidelines for securities that are rated by Moody's, S&P and Fitch and the lower rating for securities rated by only two of such agencies. For securities that are rated by only one rating agency, the Sub-Manager(s) and Separate Accounts will use the rating assigned by such agency. If a security is downgraded below the minimum credit quality set forth herein, the Sub-Manager(s) and Separate Accounts will dispose of the security in a prudent manner, with a target disposition of 30 days after the date of the downgrade.

For purposes of the above guidelines, investments in U.S. government and government agency obligations will be deemed rated Aaa/AAA.

(6) **Duration**. The Sub-Manager(s) and Separate Accounts will manage the duration within a range of 80% - 120% of the duration of the assigned benchmark index.

## IV. <u>DEFINITIONS</u>

**"ABS" - Asset Backed Security**
Securities collateralized by the cash flows from a specified pool of underlying assets, such as common receivables like credit cards payments, home equity and auto loans.

**"CBO" – Collateralized Bond Obligation**
An investment-grade bond backed by a large, diversified pool of junk bonds. Usually broken down into tiers with varying degrees of risk and varying interest rates.

**"CDO" – Collateralized Debt Obligation**
A type of structured asset-backed security (ABS) whose value and payments are derived from a portfolio of fixed-income underlying assets

**"CLO" – Collateralized Loan Obligation**
A debt security backed by a pool of commercial loans.

**"CMO" – Collateralized Mortgage Obligation**
Securities backed by pools of mortgage payments, separated into different maturity classes called tranches.

**"ERISA" – Employee Retirement Income Security Act of 1974**
The federal law which established legal guidelines for private pension plan administration and investment practices.

**"IO" – Interest Only Bond**
The interest portion of mortgage, Treasury or bond payments, which is separated and sold individually from the principal portion of those same payments. The periodic payments of several bonds can be "stripped" to form synthetic zero-coupon bonds.

**"Inverse IO" – Inverse Interest Only Bond**
A fixed income instrument which has a coupon rate or interest rate that varies with a short term interest rate index such as the London Interbank Offered Rate (LIBOR), the Constant Maturity Treasury (CMT) or the Cost of Funds Index (COFI) in such a way that the yield is inversely related.

**"MBS" – Mortgage Backed Security**
Securities backed by a pool of residential mortgage payments.

**"PO" – Principal Only Bond**

A type of fixed-income security where the holder is only entitled to receive regular cash flows that are derived from incoming principal repayments on an underlying loan pool. The loan is often a pool of mortgages in the form of a mortgage-backed security (MBS).