

**CITY OF PHOENIX**

**457 DEFERRED COMPENSATION AND  
401(a) DEFINED CONTRIBUTION PLANS**

**INVESTMENT POLICY STATEMENT**

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Prepared by Hyas Group LLC

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## **INTRODUCTION AND PURPOSE**

This statement is set forth to provide an outline of the investment policies, guidelines, and objectives for the administration of the City of Phoenix 457 Deferred Compensation and 401(a) Defined Contribution Plans (hereinafter “Plan or Plans”) as it relates to the investment options in those Plans. The 457 Deferred Compensation Plan is a voluntary, salary deferral retirement plan, available to eligible City of Phoenix employees, that provides a vehicle for the deferral of employee compensation to be used for retirement savings and to supplement other retirement savings sources. Contributions to the 401(a) Defined Contribution Plan are comprised of various employer contributions, as well as employee voluntary salary deferrals which are irrevocable. The purpose of both Plans is to attract and retain talented employees with a competitive and flexible program designed to enhance their future retirement security. The Plans are participant-directed, and participants select from among the available investment options.

This Investment Policy Statement is further intended to assist the fiduciaries of the Plans in making investment-related decisions in a prudent manner. It outlines the underlying philosophies and processes for the selection, monitoring and evaluation of the investment options and investment providers utilized by the Plans. This Investment Policy Statement will be reviewed at least annually, and it can be revised at any time, with the approval of the DCP Board, to reflect changes in the capital markets, plan objectives, or other factors relevant to the Plans.

## **SUMMARY OF RESPONSIBILITIES**

**Plan Sponsor** – The City of Phoenix is the Plan Sponsor. The Plan Sponsor’s responsibilities include but are not limited to:

- Adopting and amending the Plan Documents;
- Approving Plan services contracts; and
- Designating other fiduciaries of the Plans

**Board** – As provided under Ordinance G-4634 of the City of Phoenix, the Deferred Compensation Plan Board (hereinafter “Board”) has responsibility for the operation, administration, and monitoring of the Plans in accordance with the terms of the Plan Documents and written Plan policies. It is the intent of the Board to fulfill its responsibilities with respect to the Plans solely in the interest of the participants and beneficiaries.

The Board’s responsibilities also include but are not limited to the following:

- Selecting the investment design features of the Plans, including establishing the investment policy and objectives and the number and types of investment alternatives available to Plan participants;
- Appointing, monitoring, and evaluating all investment providers and managers in accordance with guidelines and benchmarks established within this document and related investment manager guidelines and consistent with applicable laws;
- Selecting and monitoring other Plan service providers, including, but not limited to, the Plan record-keeper, trustee, investment consultants, accountants, and/or any other providers; and

- Monitoring Plan costs which are charged to Plan assets and/or paid by Plan participants, including but not limited to investment management fees, custodial fees and fees paid to other plan service providers from Plan and/or participant assets.
- Ensuring that participants receive information through written and electronic media and through in-person educational opportunities addressing investment principals and risk, how to make informed investment selections, and other factors that will enhance the future benefits received from the Plans.

**Investment Consultant** - The Board may engage an independent investment consultant (hereinafter “Consultant”) to assist in carrying out the duties and responsibilities of this Investment Policy Statement. Such Consultant must be registered with Federal securities regulators pursuant to the Investment Advisors Act of 1940. The Consultant’s role is to provide information and advice to the Board on various investment related issues. The Consultant has no discretionary control or authority over the Plans and their assets. In its role as an advisor to the Board the Consultant acknowledges a fiduciary role with respect to the investment advice provided to the Board. The services of the Consultant will be set forth in a separate agreement.

**Investment Provider** – An entity that offers investment option products and manages assets for the Plans. Examples of investment option products offered by an investment provider may include mutual funds, collective investment trust funds, separately managed accounts, and variable annuity contracts.

**Investment Manager** – The person(s) representing the Investment Provider with responsibility for implementing an investment option’s investing strategy and managing its portfolio trading activities.

**Third Party Administrator** – An entity engaged to assist the Plan Sponsor and the Board in regard to the administration of the Plans. This assistance includes Plan enrollment, communication, education, including providing general investment information to Plan participants regarding the procedures for making investment choices under the Plans and general investment information regarding each of the investment options offered under the Plans, distribution processing, record keeping, and other administrative functions as prescribed in an agreement entered into between the Plan Sponsor and the Services Provider.

## **GENERAL COMPLIANCE**

The 457 Deferred Compensation and 401(a) Defined Contribution Plans are designed to meet the requirements of Section 457 and 401(a), respectively, of the Internal Revenue Code of 1986 (hereinafter “Code”), as amended. Plan participants will be solely responsible for the investment decisions and investment transactions that they make under these Plans as well as for electing the timing and form of distributions according to the terms of the Plans.

It is intended that, at minimum, Plan participants will be provided with the following opportunities:

- A. Investments that provide a reasonable opportunity:
1. To materially affect the participant’s account’s potential return and degree of risk.
  2. To choose from at least three (3) alternatives each of which is diversified and has materially different risk and return characteristics.

- a. Which in aggregate enable the participant to achieve a portfolio with aggregate risk and return characteristics at any point within the range normally appropriate for the participant.
  - b. Which when combined with the investments in the other alternatives tends to minimize through diversification the overall risk of a participant's portfolio.
- B. To make and/or modify investment decisions at least quarterly.
- C. To receive or have access to the following information, as updated:
- A description of the investment alternatives available under the Plans including a general description of the investment objectives, risk and return characteristics, and type and diversification of assets comprising each alternative;
  - Identification of the designated investment providers, investment manager(s) and investment products;
  - A description of any transaction fees or expenses charged to the Plan participant's account, and information on costs and fees for an investment product that reduces Plan participant rates of return (expense ratios); and
  - Prospectuses, annual reports, and semi-annual reports on investment products, if available.

## **GENERAL INVESTMENT POLICY, OBJECTIVES, AND STANDARDS**

The Plans intend to foster an investment environment that encourages and facilitates participant efforts to supplement other sources of retirement income. Plan participants are solely responsible for their own investment decisions, bear their own risk, and assume responsibility for the results of the investment options they select.

The primary investment objective of the Plans is to present participants with a range of investment options which give participants an opportunity to increase the value of their investment assets in a manner consistent with varying levels of participant risk/reward tolerances and investment decision-making skills. While the Plans cannot meet all plan participant investment preferences and attitudes, the Plans attempt to provide investment options for participants at various levels of investment sophistication and with varying requirements for risk and return.

Information that may also be used to select which investment options to offer includes, but is not limited to, the following:

- Age, income, and other demographic data on Plan participants
- Liquidity and administrative constraints imposed on the Plans by investment and/or service providers
- Development of new investment products in the marketplace
- Level of participant usage of a particular investment category or option

A risk/reward structure is basic to investments. Generally, those vehicles offering the greatest return over time also carry the highest risk or volatility of return. The inherent conflict between volatility and long-range asset accumulation can be lessened through diversification among asset categories or classes. To

provide participants the opportunity to select risk/reward strategies and to allow for the diversification of Plan assets, the Plans will offer a number of investment alternatives in varying asset categories. These categories will have varying return and volatility characteristics and it is the responsibility of each participant to evaluate the investment options and to select an appropriate mix. In the case of selecting Target Retirement Date funds, the current and prospective composition of the Target Date funds (based on their glide path) and the corresponding risk and return implications relative to the benchmark and peer group constituents will also be considered.

In addition to providing a range of investment options, the Plans seek to provide investment options that are competitive in terms of performance relative to appropriate investment performance and risk benchmarks. The performance and risk relationships of the Plans' investment options will be reviewed no less frequently than quarterly.

Investment options should generally be given a full market cycle to achieve stated objectives (market cycles normally occur over 3–5-year time periods). Investment options are expected to meet (in the case of passively managed/indexed options) or exceed their pre-determined benchmark index net of fees. Where peer groups are definable, actively managed investment options are expected to perform within the upper half of a sample of same style peers net of fees.

In addition to net investment performance, the options' risk characteristics will also be reviewed. The risk associated with an investment option generally should be similar to the same-style peer group. Risk-based or target retirement date asset allocation funds are a unique subset of the Plans' range of available investment options. They are designed to invest in other funds based either on the option's fixed risk profile or its variable risk profile as it shifts asset allocation over time to become more conservative. Therefore, the current and prospective composition (or asset allocation) of the Plans' asset allocation funds shall be considered when evaluating them relative to the benchmark and peer group constituents.

## **INVESTMENT OPTIONS**

Investment options offered by the Plans will be categorized or grouped by similarities in investment objectives, style, and risk. The Plans will assist participants in meeting their long-term investment objectives by providing investment options within the following permitted investment categories which shall comprise the core investment choices:

- Stable Value
- Intermediate Term Bond
- U.S. Large-Cap Equity
- U.S. Mid-Cap Equity
- U.S. Small-Cap Equity
- International Equity
- Target Date Funds

Investment options and categories may be added or deleted as the Board deems necessary. At least one investment option will be made available in each of the above categories. Specific investment options made available to participants may be either passively or actively managed. Investment options offered to participants may be comprised of a single investment product or multiple investment products grouped

together based on their asset class.

Following are descriptions of each category in the core investment options. The table following each category description contains benchmark indexes and peer groups appropriate for investment options within the category.

**STABLE VALUE**

**Objective and Description:** Provide high relative current income and a high degree of investment safety without fluctuation of principal. Investment returns are derived primarily from interest income, with the possibility of some capital appreciation (or depreciation) of the underlying investment instruments. Generally, this option will be invested in a mix of synthetic investment contracts, insurance company separate accounts, co-mingled funds, and guaranteed investment contracts, which, in aggregate, provide for a reasonable degree of liquidity. The minimum allowable credit quality for any contract is A- and the minimum credit quality for the fund is A+ The duration of the stable value portfolio will generally be less than four (4) years. Additional details on the stable value fund are contained in separate investment guidelines.

**Benchmarks and Peer Groups:**

<b>Asset Class</b>	<b>Benchmark Index</b>	<b>Peer Group</b>
Stable Value	US Treasury 5 Year Constant Maturity Note (primary), Bloomberg 1-3 Year U.S. Government Index (secondary)	US Stable Value

**INTERMEDIATE TERM BOND**

**Objective and Description:** Provide capital appreciation and income through a diversified fixed income portfolio. The expected duration for the portfolio will average five (5) years, with durations of three (3) to seven (7) years possible at times. Average credit quality will be investment grade. The fixed income portfolio will normally be comprised of money market instruments and U.S. Government and Agency bonds, mortgage and asset-backed securities, and corporate bonds (including convertibles). Foreign holdings may be included, as well as corporate securities less than investment grade.

**Benchmarks and Peer Groups:**

<b>Asset Class</b>	<b>Benchmark Index</b>	<b>Peer Group</b>
Intermediate Term Bond	Bloomberg US Aggregate Bond	US Intermediate Term Core-Plus Bond or US Intermediate Term Core Bond

**U.S. LARGE-CAP EQUITY**

**Objective and Description:** Provide long-term capital appreciation through a diversified common stock portfolio whose average market capitalization may be categorized as Large Cap by an industry standard data provider\*. Equities of foreign companies may also be included but would generally not exceed 20% of the portfolio.

**Benchmarks and Peer Groups:**

<b>Asset Class</b>	<b>Benchmark Index</b>	<b>Peer Group</b>
Large Cap Value	Russell 1000 Value	US Large Value
Large Cap Blend	S&P 500	US Large Blend
Large Cap Growth	Russell 1000 Growth	US Large Growth

**U.S. MID-CAP EQUITY**

**Objective and Description:** Provide long-term capital appreciation through a diversified common stock portfolio whose average market capitalization may be categorized as Mid Cap by an industry standard data provider\*. Equities of foreign companies may also be included but would generally not exceed 20% of the portfolio.

**Benchmarks and Peer Groups:**

<b>Asset Class</b>	<b>Benchmark Index</b>	<b>Peer Group</b>
Mid Cap Value	Russell Mid Cap Value	US Mid Value
Mid Cap Blend	Russell Mid Cap or Custom US Mid Cap Index	US Mid Blend
Mid Cap Growth	Russell Mid Growth	US Mid Growth

**U.S. SMALL-CAP EQUITY**

**Objective and Description:** Provide long-term capital appreciation through a diversified common stock portfolio whose average market capitalization may be categorized as Small Cap by an industry standard data provider\*. Equities of foreign companies may also be included but would generally not exceed 20% of the portfolio.

**Benchmarks and Peer Groups:**

<b>Asset Class</b>	<b>Benchmark Index</b>	<b>Peer Group</b>
Small Cap Value	Russell 2000 Value	US Small Value
Small Cap Blend	Russell 2000 or Custom US Small Cap Index	US Small Blend
Small Cap Growth	Russell 2000 Growth	US Small Growth

\*"Industry standard data provider" is defined as a company that aggregates, standardizes, and broadly distributes investment data to industry professionals. Examples currently include Morningstar and Lipper.

**INTERNATIONAL EQUITY**



**Objective and Description:** Provide long-term capital appreciation through a diversified portfolio of international equities. Equities of companies operating out of emerging countries may be used at the discretion of the manager but would generally not exceed 30% of the portfolio.

**Benchmarks and Peer Groups:**

<b>Asset Class</b>	<b>Benchmark</b>	<b>Peer Group</b>
Foreign Large Value	MSCI ACWI ex USA Value	US Foreign Large Value
Foreign Large Blend	MSCI ACWI ex USA, or Custom Combination of International Stock Indexes	US Foreign Large Blend
Foreign Large Growth	MSCI ACWI ex USA Growth	US Foreign Large Growth

**TARGET RETIREMENT DATE FUNDS**

**Objective and Description:** These portfolios are funds of funds designed to be a complete investment portfolio for participants who chose to leave the asset allocation and implementation decisions to investment professionals. Their investment objective is to provide different levels of income and capital appreciation dependent upon an individual participant’s risk tolerance and income needs. Target retirement date portfolios are designed to change their risk profile as the participant reaches his or her target retirement date. Portfolios will be well diversified across multiple asset classes generally including both fixed income and equity securities.

**Benchmarks and Peer Groups:**

<b>Asset Class</b>	<b>Benchmark</b>	<b>Peer Group</b>
Target Retirement Date	Custom Based on Target Retirement Date	US Target Date

**Brokerage Window**

In addition to investments in the above core categories, the 401(a) and 457 Plans shall maintain a brokerage window providing participants with access to an expanded array of investment choices. Specifically, the brokerage window will be provided to offer the active investor with access to a larger menu of mutual fund managers and/or individual securities, which would not be appropriate for the core options.

The DCP Board will neither encourage nor discourage participation in the brokerage window but shall endeavor in its communication efforts to emphasize that the specific utility of this investment option is for those active investors interested in obtaining access to a larger menu of fund managers and/or individual securities, which would not be appropriate for the core options.

The DCP Board will strive to provide a brokerage window option which will meet the following objectives:

1. It should provide a broad array of investment choices;
2. It should be made available at the lowest cost to participants consistent with quality of basic service levels including competent execution of transactions, reporting reliability and responsiveness to participant inquiries; and
3. Consistent with the 401(a) and 457 Plans' core options; it should permit to the maximum extent possible trading without application of special fees or restrictions.

## **INVESTMENT OPTION SELECTION GUIDELINES**

Investment options offered to participants will be provided through investment provider(s) accessible on the Third Party Administrator's platform. Before introducing a new investment option, the Board, in consultation with the Consultant and Third Party Administrator, will define the niche to be filled and assess any prospective investment option's performance, quality and risk characteristics. At a minimum, investment options under consideration should satisfy performance and risk considerations under actual, not modeled, conditions and over an appropriate time period. The due diligence process to be followed in selecting an investment provider should include, but not be limited to, an analysis of the following factors:

- Length of investment performance track record and consistency of returns achieved with risks taken;
- Relative investment performance as compared to predetermined benchmarks and peer groups;
- Alignment of investment philosophy, process, and style with Plan objectives;
- Size and experience of professional staff;
- Tenure of investment management team;
- Competitiveness of investment management fees;
- Any pending regulatory investigations, censures, conflicts of interest or material legal proceedings.
- Documentation of such analysis shall be maintained in compliance with records retention laws by the financial consultant and made available to the Board or staff upon request.

## **INVESTMENT OPTION REVIEW, GUIDELINES AND MONITORING**

Investment providers and investment managers are required to comply with all applicable laws, rules, and regulations. However, the Board takes no responsibility for the failure of such option and/or investment manager to comply with any and all applicable laws, rules, or regulations.

All options must have readily ascertainable market values and be easily marketable. It is recognized that Stable Value/GIC funds often have liquidity restrictions. Investment options with sales loads, redemption fees, or other non-investment management related expenses will be avoided to the extent possible. Options with deferred sales charges and/or market value adjustments will not be permitted.

Each investment option portfolio shall be diversified adequately to reduce risk and comply with current

regulations and applicable Arizona state laws.

Investment option performance, risk and style consistency is intended to be evaluated on a quarterly basis. Measurements shall be reported for at least the most recent quarter, year, three-year and five-year periods. Performance and risk results will be evaluated using comparisons with this policy, pertinent market indices and against other same-style peers, where definable. When necessary, investment option performance and risk may be reviewed more frequently.

The Board will periodically review the investment options' progress in meeting the Plan's investment objectives, as reported by the Consultant. Based on that input and upon recommendation from the Consultant, the Board may decide to request that the Board's Investment Selection Subcommittee convene to meet with the Consultant to determine an appropriate recommendation to make to the full Board. Upon approval of a recommendation, the Board may eliminate a fund manager and/or replace or hire additional fund manager(s) with an investment asset class in the Plan at any given time. Investment options are expected to comply with all stated investment objectives, guidelines, and applicable rules contained in the prospectus, offering document, or fund fact sheet, if applicable. Investment performance reviews may include, but are not limited to, a review of:

- Investment portfolios;
- Fees and expenses;
- Investment style, process, and philosophy;
- Investment management personnel; and
- Index tracking error.

The performance review will also include measuring the options' investment performance relative to stated benchmarks or respective indexes and peer groups as well as risk measures. The following will be evaluated:

### **Quantitative Measures**

**Active Investment Strategies.** Options employing active management are expected to outperform their stated asset class or style benchmark net of all management fees over a trailing five-year time period; and to rank above the 50<sup>th</sup> percentile of the appropriate peer group for the same trailing five-year time period. It is also expected that the risk of each option, as defined by standard deviation of returns, be commensurate with the prescribed strategy relative to the appropriate market index and/or peer group.

**Passive Investment Strategies.** Passively managed options are expected to track the performance of the index strategy that the option is designed to replicate, less management fees, with marginal tracking error over the trailing five-year period. It is also expected that the risk of each passive option, as defined by standard deviation of returns, be commensurate with the appropriate market index.

### **Qualitative Measures**

The options will also be monitored on an ongoing basis for other material changes which the Board may determine are of importance to the decision of whether or not to retain an investment option, such as personnel departures; organizational changes; or alterations in investment style, philosophy, or strategy;

and adherence to stated guidelines.

**Time Periods.** The Board acknowledges that fluctuating rates of return characterize the securities markets, particularly during short-term time-periods. Recognizing that short-term fluctuations may cause variations in an option's performance, the Board intends to employ investment options with long-term investment strategies and will evaluate option performance from a long-term perspective. Performance over market cycles of three to five years will be weighted more heavily than performance over shorter time periods, such as one year or less.

In addition to the qualitative and quantitative measures referenced above, the Board will also review the investment options' risk characteristics in relation to that performance. Risk will be measured in various ways including, but not limited to:

- Standard deviation
- Up and down market performance
- Risk/return ratios such as the Sharp Ratio

**Asset Allocation Portfolios.** The Plan's asset allocation funds will be evaluated relative to a custom set of benchmarks that have been created to reflect the underlying asset allocation of each of the respective portfolios. The funds will also be compared to an appropriate peer group. In the instance of target retirement date funds, the Board shall consider their current and prospective composition (based on their glide path), and their corresponding risk and return implications relative to the benchmark and peer group constituents.

## **INVESTMENT OPTION TERMINATION AND WATCH GUIDELINES**

Generally, all investment options are expected to remain true to their stated investment objectives and to perform as well as or better than their prescribed performance benchmarks, net of fees. Periodic underperformance in any of the criteria outlined in this Investment Policy will not necessitate the termination of an option; however, underperformance will result in consideration by the Board of the factors causing underperformance and possible courses of action that the Board may take.

The Board may, at any time, place any investment option that it views as having a pattern of underperformance on a watch-status. Reasons the Board might place an option on a watch status, include but are not limited to, the following:

### **Quantitative Measures**

#### Actively Managed Options

- Performance below the prescribed benchmark index over a trailing five-year period, and
- Performance below the median of its peer group over a trailing five-year period.

#### Passively Managed Options

- Net of fee performance tracking error relative to the respective index that is greater than 20 basis points.
- Certain passive investment options operate in a marketplace that includes foreign markets whose exchanges close prior to that of the United States. In these instances, some fund managers may

engage in a method of “Fair Value Pricing,” whereby the managers adjust the pricing of securities in the fund to reflect any information that has become available after the close of the applicable foreign market. Discrepancies in performance between the applicable investment option and its performance benchmark that are due to “Fair Value Pricing” and other common index fund tracking factors (such as the timing of market closures, management fees, benchmark nuances, and others) will be taken into consideration in evaluating performance of the affected investment options.

Target Date funds will be evaluated based on the performance of the entire suite as held within the Plan. A Target Date suite will normally be viewed as being in violation of investment policy performance criteria if over one-half of the funds in a Target Date suite held within the Plan lag this Investment Policy Statement’s prescribed performance measures. The Board may elect to deviate from this approach if it appears reasonable to do so.

### **Qualitative Measures**

- Management team or another significant personnel turnover;
- Changes in the product’s investment philosophy, process, style, or risk profile;
- Excessive or rapid asset growth or decline;
- Pending regulatory investigations or material legal proceedings;
- Changes to firm ownership;
- Significant increase in management fees or expense ratio.

An investment option may remain on watch status until the Board decides to take further action. Board actions include, but are not limited to, the following:

- Removing the investment option from watch status; and
- Terminating the investment option and reallocating the assets to an alternate or replacement investment option by Board direction.

To be removed from quantitative, performance related watch status, generally, performance for the five-year trailing periods should be above the benchmark index or median for at least two consecutive quarters. If the option’s five-year trailing performance does not return to above median versus same style peers and its benchmark within two (2) quarters of being placed on watch, the option may be considered for termination. However, barring any breakdown in process, the Board may decide to leave an option on watch for as long as it believes it is prudent to do so. To be removed from non-performance related watch status generally the Board must be sufficiently satisfied that any change in process, personnel or structure will not have an adverse impact on the Plan and its participants.

The Board reserves the right to terminate investment option relationships at any time, for any reason when it determines such termination is in the best interests of the Plans and their participants and beneficiaries. Once the decision to terminate an option and remove it from the Plan is made, asset transfer and liquidation should be handled to the best advantage of the Plan, with due consideration given to the anticipated effect on affected participants and beneficiaries.