

TOBACCO INDEMNIFICATION AND COMMUNITY REVITALIZATION ENDOWMENT



TAX-EXEMPT ENDOWMENT FUND INVESTMENT GUIDELINES Statement of Investment Policies and Goals

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DEFINITIONS

Throughout this Statement of Investment Policy and Goals, the following definitions will apply:

"AMT Bond" means a "specified private activity bond" as defined in Section 57(a)(5)(C) of the Tax Code, the interest on which is a specific item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations.

"Commission" means the Tobacco Indemnification and Community Revitalization Commission created pursuant to § 3.2-3101 of the Code of Virginia.

"Commission Allocation" means 50% of the annual amount received under the Master Settlement Agreement by the Commonwealth of Virginia, or that would have been received but for a sale of such allocation pursuant to an agreement, between the commencing and ending dates specified in the agreement.

"Corpus" of the Endowment means at the time of determination, the sum of the proceeds from the sale of all or any portion of the Commission Allocation, any gifts, grants and contributions that have been credited to such Endowment, and any income not appropriated and withdrawn from the Endowment prior to June 30 of each year, less withdrawals from the Corpus. Determinations by the Treasury Board, or the State Treasurer on behalf of the Treasury Board, as to the amount of Income or the amount of Corpus shall be conclusive.

"Endowment" means the Tobacco Indemnification and Community Revitalization Endowment Established pursuant to § 3.2-3104 of the Code of Virginia.

"Expenses" means the expenses of making and disposing of investments, such as brokerage commissions, legal expenses related to a particular transaction, investment advisory and management fees and expenses, transfer taxes, custody fees and other customary transactional expenses.

"Fund" means the Tobacco Indemnification and Community Revitalization Fund established pursuant to § 3.2-3106 of the Code of Virginia.

"Income" refers to, at the time of determination, the lesser of the available cash in, or the realized investment income for the applicable period of, the Endowment. Determinations by the Treasury Board, or the State Treasurer on behalf of the Treasury Board, as to the amount of Income shall be conclusive.

"Master Custodian" refers to the bank contracted by the State Treasury to provide traditional custody and related services. Section 2.2-1807 of the Code of Virginia charges the State Treasurer with the custody of all investments and invested funds of the Commonwealth or in possession of the Commonwealth in a fiduciary capacity and with the keeping of the accounts of such investments.

"Series 2005 Bonds" means the \$448,260,000 Tobacco Settlement Financing Corporation Tobacco Settlement Asset-Backed Bonds, Series 2005, which were issued on May 16, 2005, on a tax-exempt basis and \$389,776,674.47 of the proceeds of which were used to purchase 50% of the Commission Allocation to be received from May 15, 2005, through May 14, 2104.

"Tax Certificate" refers to the Tax Certificate and Agreement dated May 16, 2005 among the Tobacco Settlement Financing Corporation, the Tobacco Indemnification and Community Revitalization Commission, the Treasury Board of the Commonwealth of Virginia and the State Treasurer of the Commonwealth of Virginia, which was executed and delivered in connection with the issuance of the Series 2005 Bonds.

"Tax Code" means the Internal Revenue Code of 1986, as amended, and the applicable provisions of the regulations of the U.S. Department of Treasury promulgated there under.

"Tax-Exempt Bond" means any bond, note or other obligation the interest on which is excludable from gross income under Section 103(a) of the Code, but shall not include an AMT Bond. In other words, for purposes of this definition, a Tax-Exempt Bond is a so-called "non-AMT" bond. By way of example and not of limitation, a Tax-Exempt Bond may be in the form of a general obligation bond, a revenue bond, a subject-to-appropriation or moral obligation bond, commercial paper, a tax, revenue or bond anticipation note, or a so-called "qualified 501(c)(3)" bond or note.

"Tax-Exempt Mutual Fund" means an interest in a regulated investment company to the extent that at least 95 percent of the income to the holder of such interest constitutes interest that is derived from Tax-Exempt Bonds. A money market fund may fall within this definition if it otherwise qualifies.

"TICR II Fund" means an account on the books of the Department of Accounts and will continue to be invested in accordance with these guidelines and the Tax Certificate pending receipt of a duly authorized requisition from the Commission requesting reimbursement for authorized expenditures from the Fund. For all purposes hereof, the "TICR II Fund" constitutes part of the Endowment.

HISTORY

The Master Settlement Agreement (“MSA”) was entered into on November 23, 1998, among the attorneys general of 46 states (including Virginia), the District of Columbia, the Commonwealth of Puerto Rico, Guam, the U.S. Virgin Islands, American Samoa and the Commonwealth of the Northern Mariana Islands and the four largest United States tobacco manufacturers. Under the MSA, the Commonwealth is entitled to annual payments which are distributed through the National Escrow Agreement, entered into on December 23, 1998, among the Settling States, the Original Participating Manufacturers and the MSA Escrow Agent.

Pursuant to authorization granted by Chapters 482 and 488 of the Acts of the General Assembly of the Commonwealth of Virginia, 2002 General Session (the “Tobacco Settlement Financing Corporation Act” or the “Act”), the Commonwealth was authorized to sell up to 50% of amounts received under the MSA and allocate the proceeds to the Tobacco Indemnification and Community Revitalization Endowment (“Endowment”). The Endowment is used by the Tobacco Indemnification and Community Revitalization Commission (“Commission”) to provide payments to tobacco farmers as compensation for the adverse economic effects resulting from the loss of tobacco production opportunities associated with a decline in quotas, and to provide grants and other funds to aid in the revitalization of tobacco dependent communities.

On May 16, 2005 at the request of the Commission, the Tobacco Settlement Financing Corporation (the “Corporation”) issued its \$448,260,000 Tobacco Settlement Asset-Backed Bonds, Series 2005 (the “2005 Bonds”) to purchase from the Commonwealth 25% of the amount to be received by the Commonwealth under the MSA (or that would have been received but for the sale of such right, title and interest), from May 15, 2005, through May 14, 2104. Net proceeds of the tax-exempt issue were placed in the Endowment for use by the Commission in accordance with § 3.2-3100 et seq. *Code of Virginia*.

On May 3, 2007, again at the request of the Commission, the Corporation issued its \$1,149,273,282.50 Tobacco Settlement Asset-Backed Bonds, Series 2007 (the “2007 Bonds”). Net proceeds of the 2007 Bonds were used to (i) advance refund the outstanding Series 2005 Bonds and (ii) to pay the purchase price of an additional 25% of all amounts received by the Commonwealth under the MSA from April 27, 2007, through May 14, 2104 for deposit to the Endowment. The 2007 Bonds have stated maturities of 2046 and 2047, but depending on MSA receipts, may be paid off as early as 2032. In order to provide flexibility as to the use of the Endowment, the Commission requested the portion of the 2007 Bonds used to purchase the additional 25% of the MSA be issued on a taxable basis. Consequently, while the Endowment established by the Series 2005 Bonds must be invested and expended as permitted under the federal tax code for tax-exempt bonds, the Endowment established with the proceeds of the 2007 Bonds (the “2007 Endowment”) may be invested and expended without the same restrictions.

OVERVIEW

The Endowment shall be under the management and control of the Treasury Board of the Commonwealth of Virginia. The Endowment shall receive any proceeds from any sale of all or any portion of the Commission Allocation, and any gifts, grants and contributions that are specifically designated for inclusion in such Endowment. No part of the Endowment, neither Corpus nor Income, or interest thereon, shall revert to the general fund of the State Treasury.

This document sets forth the responsibilities of the Treasury Board and its investment managers relating to the implementation of the investment policy, asset strategy, evaluation and review of investment performance and progress toward attaining goals.

Treasury Board Responsibilities

1. The Treasury Board shall serve as trustee of the Endowment and the Corpus and Income of the Endowment shall be withdrawn and credited to the Fund by order of the Treasury Board.
2. The Treasury Board shall have full power to invest and reinvest funds credited to the Endowment in accordance with the provisions of the Uniform Management of Institutional Funds Act (§ 55-268.11 et seq.) and, in addition, as otherwise provided by law.
3. The Treasury Board may borrow money in such amounts as may be necessary whenever in its judgment it would be more advantageous to borrow money than to sell securities held for the Fund. Any debt so incurred may be evidenced by notes duly authorized by resolution of the Treasury Board, such notes to be retired no later than the end of the biennium in which such debt is incurred.
4. The Treasury Board may commingle, for purposes of investment, the Corpus of the Endowment provided that it shall appropriately account for the investments credited to the Endowment.
5. The Treasury Board may hire independent investment advisors and managers as it deems appropriate to assist with investing the Endowment. Expenses shall be payable out of the available cash in, or the realized investment income for the applicable period of, the Endowment.
6. The Treasury Board, in accordance with §2.2-2416 (9) and as formally approved by the Treasury Board on April 14, 2021, delegates to the State Treasurer responsibility for executing its responsibilities for the Tobacco Indemnification and Community Revitalization (TICR) Tax-Exempt Endowment as described in these guidelines.

Endowment Objectives

Investments should be made in a manner which will balance the highest investment return consistent with sufficient security to assure Treasury meets the annual cash flow demands of the Endowment and conforming to all statutes and regulatory requirements governing the investment of the Fund. No investment shall be made to cause the interest on the Series 2005 Bonds to be deemed taxable. Determinations by the Treasury Board, or the State Treasurer on behalf of the Treasury Board, as to the amount of Income or the amount of the Corpus shall be conclusive. Investments shall be made with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.

In order to maintain the tax-exempt status of the Series 2005 Bonds, Section 149(g) of the Tax Code requires that at least 95 percent of the unexpended net proceeds of such bonds be continuously invested in Tax-Exempt Bonds or Tax-Exempt Mutual Funds. The Treasury Board has determined that all of the Corpus and Income of the Endowment will be invested in Tax-Exempt Bonds or Tax-Exempt Mutual Funds.

The Income of the Endowment shall be paid out at least annually to the Fund. In addition, up to 10% of the Corpus of the Endowment shall be paid to the Fund annually upon request by two-thirds vote and resolution of the Commission to the Treasury Board; provided, however, that upon three-fourths vote of the Commission, up to 15% of the Corpus of the Endowment shall be so paid. No use of proceeds shall be made that would cause the interest on the Series 2005 Bonds to be deemed taxable.

Due to limitations imposed by the Tax Certificate, Income and Corpus paid out from the Endowment shall be credited to the "TICR II Fund".

POLICY GUIDELINES

Tax-Exempt Endowment Structure

In order to meet the Endowment objectives, the Endowment will be split between two types of accounts.

The Endowment will be externally managed by investment advisors that specialize in the investment management of tax-exempt securities. The objectives of the Endowment are to (i) be fully invested at all times in either Tax-Exempt Bonds or Tax-Exempt Mutual Funds and (ii) generate a net of fee investment return, over the long-term, higher than the return of the appropriate benchmark. To generate higher investment returns, it is recognized that additional interest rate risk, within prudent constraints, must be assumed in the management of the Endowment. To further control these risks, and to provide for sufficient management flexibility, the Endowment may be structured into Short or Intermediate Duration Tax-Exempt Portfolios based upon an assessment of market conditions, Endowment time horizon, or other risk factors as deemed appropriate. Additionally, a money market Tax-Exempt Mutual Fund may be used to cover short-term disbursements. This money market fund will be under the control of the Treasury. **In seeking higher investment returns, the portfolio managers of the Endowment will be cognizant of the Treasury Board's objectives of safety of principal and liquidity.**

Asset Mix Policy

The allocation guidelines for the Endowment are:

	<u>Target</u>	<u>Minimum</u>	<u>Maximum</u>
Tax-Exempt Money Market Fund	As needed	0%	25%
Short & Intermediate Duration Tax-Exempt Portfolio	100%	0%	100%

The intent of the Asset Mix Policy is to increase the overall average maturity of the Endowment to enhance the returns over the long-term. Deviations from the allocation targets for the Endowment, and from the guidelines for the Tax-Exempt Endowment listed below, may be made by the Treasury Investment Staff, when liquidity needs warrant, or when the Treasury Staff determines that the aggregate deviation does not constitute a material departure from the spirit of the target allocation and the intent of the Treasury Board. The Treasury Investment Staff shall review the target allocations and guidelines at least annually. If desired, the Short Duration and Intermediate Duration Tax-Exempt Portfolios may be consolidated and managed under a single investment manager mandate with underlying allocations that correspond to target.

Investment Guidelines and Restrictions

Authorized Investments for the Endowment

All investments must be denominated in U.S. Dollars.

Funds in the Endowment may be invested and reinvested in accordance with the Uniform Management of Institutional Funds Act § 55-268.11 et seq. of the Code of Virginia. The following investments are permitted:

1. Short-Term Tax-Exempt Cash Equivalents: Commercial paper falling within the definition of Tax-Exempt Bonds and money market Tax-Exempt Mutual Funds.
2. Tax-Exempt Bonds issued by states, political subdivisions, and agencies of the fifty United States, D.C. and its territories.

Credit Quality

The State Treasurer will in all cases place emphasis on securities of high credit quality and marketability. Holdings are subject to the following credit quality limitations at time of purchase.

1. Long-term Tax-Exempt Bonds must be rated at least A3/A- or equivalent by two nationally recognized rating agencies (one of which must be either Moody's Investors Service, Standard & Poor's, or Fitch). Split-rated securities shall be assumed to have the lower credit grade and single-rated securities are not permitted.
2. Money market and other short-term investments, including tax-exempt commercial paper, must be rated a minimum of A-1/P-1/F-1 or comparable by Standard & Poor's, Moody's Investor Services, or Fitch, respectively.

The portfolio should maintain a weighted average portfolio rating of AA/Aa2 or better.

Downgraded Securities (Out-of-Compliance)

Should a security fail to meet the required credit quality limitations after purchase (i.e. credit downgrades), the manager shall notify the Treasury Investment Staff and the Investment Consultant in writing promptly after the security fails to meet the credit quality limitations. Such security must then be sold within 30 calendar days, unless retention of the security is approved in writing by the Treasury Investment staff.

If a manager is allowed to retain an out-of-compliance security, the manager shall submit a monthly write-up to the Treasury Investment Staff and the Investment Consultant. The write-up must include the manager's rationale (both qualitative and quantitative) on why they believe the security should continue to be considered for an exception.

Diversification

The State Treasurer will diversify investments by security type and by issue and the following shall apply for each manager:

1. Each portfolio will be diversified with no more than 4% of the value of the fund invested in the securities of any single issuer.
2. The maximum percentage of each portfolio within the Endowment in each sector is as follows:

General Obligation Bonds	75%
Revenue Bonds	60%
Pre-refunded Bonds*	40%
All Other Types of Tax-Exempt Bonds	10%
Tax-exempt Money Market Funds (excluding transitional cash)	10%
Tax-exempt money market funds controlled by the Treasury – not applicable to externally managed portfolios	no limit

* Pre-refunded bonds are permitted provided that the bonds are escrowed with U.S. Treasury and Agency securities..

3. The maximum percentage of each portfolio within the Endowment in each state is as follows:

Single State	15%
Top Five States	50%

4. The minimum issue size is \$2 million.

Prohibited Investments or Actions

Any investment other than Tax-Exempt Bonds or Tax-Exempt Mutual Funds.

Duration Limitations

To the extent necessary, the State Treasurer will attempt to match investments with anticipated cash requirements. Additional funds will be invested at maturities determined to be most beneficial to the portfolio. The following duration limitations shall apply:

1. The maximum duration for any single Tax-Exempt Bond may not exceed 15 years at time of purchase. In the event the duration subsequently exceeds these limits, the investment advisor shall notify the Treasury Investment Officer or Director and the Investment Consultant who shall determine whether the security should be sold.
2. The target duration (years) for the Endowment is as follows:

	<u>Target Duration</u>
Short & Intermediate Duration Tax-Exempt Portfolio	Benchmark

3. Portfolio durations are designed to target the respective benchmark duration with a +/-10% deviation. The Asset Mix Policy and the target duration guidelines shall be reviewed at least annually by the Treasury Investment Staff, and modified as conditions warrant.

For purposes of this section, duration shall be defined as the industry standard modified duration as calculated by Bloomberg or other well established models available.

Tax-Exempt Endowment Benchmarks

Tax-Exempt Endowment (Short & Intermediate Duration Portfolio):

25% Bloomberg Municipal 1-3 Year A and Above, 75% Bloomberg Municipal 5-10 Year A and Above Index

If desired, the Short Duration and Intermediate Duration Tax Exempt Portfolios may be consolidated and managed under a single investment manager mandate and compared against a blended benchmark.

All Endowment benchmarks will be reviewed annually, and adjusted based upon changes in the Endowment's Structure and/or changes in its objectives.

STANDARDS OF INVESTMENT PERFORMANCE

Performance results for the Endowment, and for each component, shall be time-weighted and measured net of investment management fees.

STANDARDS OF INVESTMENT PERFORMANCE

Tax-Exempt Endowment	Exceed the Endowment benchmark
	Underperformance should not exceed 50 basis points per annum over a rolling 4 quarter period.
Short & Intermediate Duration Tax-Exempt Portfolio Managers	Exceed the Short & Intermediate Duration Tax-Exempt Portfolio benchmark
	Underperformance should not exceed 50 basis points per annum over a rolling 4 quarter period.

REPORTING REQUIREMENTS

Treasury Responsibilities

The State Treasurer is charged with the responsibility of reporting to the Treasury Board on a quarterly basis. These reports will include investment performance information, security holdings by manager, and security market values by manager. The State Treasurer has contracted with the Master Custodian to run compliance reports on the external investment portfolios. These compliance reports are comprised of various screens or tests of both individual security and total portfolio guidelines. Any significant or continuing problems will be reported to the Treasury Board. Additional information will be provided if deemed appropriate or if requested. This Statement of Investment Policy & Goals shall be reviewed at least annually by the Treasury Staff and, if appropriate, amended at such times, as the Treasury Board shall determine.

Investment Consultant Responsibilities

The investment consultant shall:

1. Prepare a quarterly performance evaluation that details the performance, asset allocation and compliance with these guidelines for each manager and the combined Endowment.
2. Make reports to the Treasury Board as requested.

Investment Manager Responsibilities

Each investment manager shall:

1. Within 30 days of each month-end, reconcile all transactions, market values, security holdings, and cash flows with the Endowment's Master Custodian and provide a written report to the Custodian, with a copy to the Treasury Staff and Investment Consultant of all areas of discrepancy or disagreement with the Master Custodian.
2. Report monthly performance against the benchmarks established for the account by the fifth business day of the following month to Treasury Staff, the Investment Consultant and Master Custodian.
3. Provide a monthly report that lists each out-of-compliance security, if any, and detailed rationale for continuing to hold and the targeted outcome.
4. Provide quantitative quarterly performance attribution relative to the appropriate benchmark. Provide quarterly reports concerning investment strategy, including quantitative performance attribution based on interest rate risk, sector allocation and security selection. Provide an economic and investment outlook by the end of the following month.
5. Provide a quarterly accounting of any professional staff turnover that would impact this relationship. Any material event that has an impact on the ownership of the investment organization or the management of this account must be reported

immediately to Treasury Investment Staff and the Investment Consultant

6. Attend meetings as requested with Treasury Staff and the Investment Consultant to review the performance of the portfolio, current economic and market conditions, economic and market outlook, and the investment policies and goals of the Endowment.