

Federated City Employees' Retiree Health Care Trust Fund

Investment Policy Statement

Approved by the Board of Administration 3/21/2013

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- 1) This investment policy statement governs investments for the City of San Jose Federated City Employees' Retiree Health Care Trust Fund ("the Fund"). The Fund is an Internal Revenue Code Section 115 trust which was established on June 24, 2011. The Fund is outside of the Federated City Employees' Retirement System ("System"). for the payment of retiree healthcare benefits in order to provide an alternative to the existing 401(h) account, which is within the System.
- 2) The Fund will be managed as an ongoing concern with a long-term investment time horizon, consistent with the demographic profile of the members and beneficiaries of the System.

INVESTMENT OBJECTIVES

- 3) The primary objective of the investment portfolio is to provide a funding source for the subsidizing of postretirement healthcare benefits to members of the San Jose Federated City Employees' Retirement System and their beneficiaries.
 - a) A range of risks will be monitored in connection with the Fund, with an emphasis on the risk of loss of Fund assets.
- 4) In developing the investment policies of the Fund, various factors will be considered including, but not limited to:
 - a) The structure and duration of the Fund's liabilities.
 - b) Modern Portfolio Theory.
 - c) The portfolio management practices followed by other institutional investors.
 - d) The liquidity needs of the Fund.

FIDUCIARY STANDARDS

- 5) The Trustees are subject to the following duties under law:¹
 - a) The assets of the Fund are trust funds and shall be held for the exclusive purposes of providing benefits to members of the System and their beneficiaries and defraying reasonable expenses of administering the Fund.
 - b) The Trustees shall discharge their duties with respect to the Fund solely in the interest of, and for the exclusive purposes of providing benefits to, members of the System and their beneficiaries, maintaining the actuarial soundness of the System, and defraying reasonable expenses of administering the Fund. The Trustees' duties to the members and their beneficiaries shall take precedence over any other duty.
 - c) The Trustees shall discharge their duties with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of like character and with like aims.
 - d) The Trustees shall diversify the investments of the Fund so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is clearly not prudent to do so.
- 6) Investment staff, investment consultants, investment managers, custodians and all other parties charged with handling the Fund's assets shall utilize the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of like character and with like aims, and shall comply with all applicable laws, rules and regulations.

¹ Per section 350 of Chapter 3.28, 1975 Federated Employees Retirement Plan.

FUND GOVERNANCE

- 7) The governance structure of the Fund is described in the City Charter and in various governance policies established by the Board of Administration, including but not limited to:
- a) Policy on the Role of the Board of Administration
 - b) Policy on the Role of the Investment Committee
 - c) Policy on the Role of the Director of Retirement Services
 - d) Policy on the Role of the Chief Investment Officer
 - e) Policy on Roles in Vendor Selection

ASSET ALLOCATION

- 8) The current asset allocation policy of the Fund (at market value) as of 12/31/2012 is set out below:

Federated City Employees' Retiree Health Care Trust Fund			
<i>Broad Asset Class</i>	<i>Minimum (%)</i>	<i>Target (%)</i>	<i>Maximum (%)</i>
Global Equity	53	59	65
Fixed Income	23	28	33
Real Assets	8	13	18
Total		100	

- 9) The Trustees are committed to implementing and maintaining the above asset allocation policy, but also recognizes that circumstances may arise where it is not possible or practical to timely implement or maintain the policy. In such circumstance, the Trustees will monitor the status of the asset allocation policy and seek to comply with the policy when it is possible and prudent to do so.
- 10) The asset allocation policy of the Fund will be reviewed at a minimum every five years.
- 11) The Trustees will also approve an Investment Structure, which provides additional detail as to the allocation of assets to categories of investment within the broad asset classes that comprise the asset allocation policy.

REBALANCING

- 12) The asset allocation of the Fund will be monitored on a monthly basis and the assets of the Fund are to be rebalanced, by Staff, to within the target ranges when fluctuations in market values cause the portfolio to fall outside the guideline ranges set out above. Such re-balancing shall occur as soon as practical unless the approval of the Investment Committee is obtained.
- 13) When re-balancing, funds will generally be taken from accounts that are most significantly above their approved ranges and will be transferred to accounts that are most significantly below their approved ranges until allocation is within the guideline ranges, also taking into account liquidity and transactional cost considerations. An asset allocation overlay service may be engaged to monitor allocation and to initiate rebalancing actions to maintain the portfolio in accordance with these guidelines. The Fund will be rebalanced to tactical rather than long-term target allocations in circumstances where the Trustees have approved a tactical allocation.

DIVERSIFICATION

- 14) Investments shall be diversified with the intent to minimize the risk of large investment losses. Consequently, the total portfolio will be constructed and maintained to provide prudent diversification with regard to the concentration of holdings in individual issues, issuers, or industries. Furthermore, assets will be assigned to a variety of investment managers that employ a range of investment management strategies.

LIQUIDITY MANAGEMENT

- 15) The projected cash flow needs of the Fund are to be reviewed at least quarterly and the custodian and investment managers of the Fund are to be informed in writing in a timely manner of the liquidity needs of the Fund. If necessary, cash flow needs will be coordinated through the Fund's rebalancing provisions contained herein.

PROXY VOTING

- 16) The Trustees recognize that the voting of proxies is important to the overall performance of the System. The Trustees have delegated the responsibility of voting all proxies to the investment managers or a third party service provider. The Trustees expect that the proxy voting service will execute all proxies in a timely fashion and in the best interest of plan members and beneficiaries. Also, the Trustees expect the managers to provide a full accounting of all proxy votes, and upon request, a written explanation of individual voting decisions. The Trustees intend to review the managers' proxy voting on at least an annual basis.

HIRING & TERMINATING INVESTMENT MANAGERS

- 17) Investment managers should meet the following criteria in order to be considered to manage the assets of the Fund.
 - a) Be capable of providing adequate and satisfactory information on the history of the firm, key personnel, key clients, fee schedules, and support personnel. Such information must demonstrate acceptable financial and staff stability and longevity.
 - b) Be able to clearly articulate the investment strategy that will be followed and demonstrate that the strategy has been successfully adhered to over time.
 - c) Have no past or outstanding legal judgments against them, which reflect negatively upon the firm or call into question the ability of the firm to serve as a fiduciary of the System.
- 18) As a general rule, Fund assets placed with an investment manager should not represent more than 10% of the total assets managed by that firm. Exceptions to this rule shall require the approval of the Trustees.

MONITORING INVESTMENT MANAGERS

- 19) The Fund's investment managers will be monitored on an ongoing basis and may be terminated by the Fund at any time due to performance or other developments that call into question the manager's ability to continue to effectively manage assets of the Fund.
- 20) The majority of the Fund's assets are currently passively managed, in which case the manager should be expected to produce long-term returns that are reasonably close to those of the relevant benchmark. For any active investment managers, quarterly performance will be measured and evaluated relative to appropriate

long-term performance benchmark and objectives, though it is understood that investment managers will, from time to time, underperform their benchmarks and objectives. Persistent underperformance by an investment manager, however, will be viewed as the basis for an extraordinary review of that manager and the manager's potential termination.

- 21) Certain other events may also trigger an extraordinary review, and possible termination, of an investment manager. These include, but are not limited to:
 - a) Failure to adhere to the terms of a contract between the manager and the Fund.
 - b) Loss of an investment professional(s) directly responsible for managing the Fund's assets, or who is/are so significant to the firm's overall investment process as to call into question the future efficacy of that process.
 - c) The sale of the investment management firm to another entity, or other change in ownership.
 - d) The purchase of another entity by the investment management firm.
 - e) Significant account losses and/or extraordinary addition of new accounts.
 - f) Regulatory actions against the firm, particularly any that represent violations of securities laws and regulations.
 - g) Any other event which may impair the manager's ability to perform in a satisfactory manner or puts the Fund's assets at undue risk of loss.

DERIVATIVE SECURITIES

- 22) Derivative securities are financial instruments that "derive" their value from an underlying commodity, index, or security. Examples include futures, options and forward contracts. Derivatives can provide a cost-effective means of managing portions of a portfolio and to manage risk through hedging activities. Examples of such uses include:
 - a) Equitizing cash during portfolio transitions until "physical" securities are in place.
 - b) Managing asset allocation on a temporary basis.
 - c) Hedging foreign currency risk, subject to approved limits.
- 23) In general, the use of derivatives for the purposes noted above, and similar risk management purposes, is supported by the Investment Committee and the Trustees. Speculative positions in derivatives however are not authorized under any circumstances.
- 24) The Fund is currently authorized to use derivatives strategies to equitize cash during portfolio transitions until physical securities are in place, and to reproduce or replicate a physical holding that corresponds to a Board-approved policy benchmark. Additional derivatives strategies must similarly be authorized by this Investment Policy Statement prior to being utilized within the Fund.
- 25) Given the nature of many commodity manager mandates, it is recognized and understood that commodity managers retained by the Fund may use derivatives that are contrary to paragraphs 23 and 24 above.

INVESTMENT RESTRICTIONS

- 26) Fund assets are currently invested primarily in mutual fund investment vehicles, given the current asset size of the Fund. The type of investment vehicles utilized by the Fund will be revisited as the asset size of the Fund increases. In instances when the Fund invests through a commingled fund or separate account, investment management agreements will be established for each investment manager retained by the Fund. Such agreements shall specify any policies, risk controls, portfolio characteristics, reporting requirements, and other requirements or restrictions that may be applicable to the manager.

INVESTMENT COSTS

- 27) The Trustees intend to monitor and control investment costs at every level of the Fund.
- i) Professional fees will be negotiated whenever possible.
 - ii) Where appropriate, passive portfolios will be used to minimize management fees and portfolio turnover.
 - iii) If possible, assets will be transferred in-kind during manager transitions and Fund restructurings to eliminate unnecessary turnover expenses.
 - iv) Managers will be instructed to minimize brokerage and execution costs.

VALUATION OF INVESTMENTS

- 28) The Fund's investments shall be valued using market values or other suitable methods of valuation. The frequency of valuation shall be dependent upon the nature of the asset.
- 29) Where a public market price is not available for an investment, a suitable method of valuation shall be used including the use of: discounted cash flows, earnings multiples, appraisals, prevailing market rates for instruments with similar characteristics or other pricing models as appropriate. Independent, qualified appraisers may be used to provide valuations or verify the reasonableness of internal valuations.

OTHER

- 30) Appendix A contains the long-term Policy Benchmark.
- 31) Exceptions to this Investment Policy Statement must be approved by the Trustees.

POLICY REVIEW & HISTORY

- 32) This policy will be reviewed at least annually.
- 33) This policy was most recently on March 21, 2013.

APPENDIX A

Long-term Policy Benchmark

Federated City Employees' Retiree Health Care Trust Fund		
Asset Class	Benchmark	Target (%)
Global Equity	Russell 3000	26.5
	MSCI EAFE	26.5
	MSCI Emerging Markets	6.0
Fixed Income		
Investment Grade	Barclays Aggregate Float Adjusted	16.0
TIPS	Barclays US TIPS	12.0
Real Assets	Risk Parity Commodities	13.0