

San Jose Police and Fire Retiree Health Care Trust Fund

Investment Policy Statement

Approved by the Board of Administration on 6/6/2013

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- 1) This investment policy statement governs investments for the City of San Jose Police and Fire Department Retiree Health Care Trust Fund (the "Health Care Trust"). The Health Care Trust is an Internal Revenue Code Section 115 trust that was established on June 24, 2012. The Health Care Trust is separate from the City of San Jose Police and Fire Department Retirement Plan (the "Plan"), and contributed assets are to be used for the sole purpose of providing healthcare benefits to Plan beneficiaries. The Health Care Trust was established to provide an alternative to the existing 401(h) account, which is included within the Plan.
- 2) The Fund will be managed as an ongoing concern with a long-term investment time horizon.

INVESTMENT OBJECTIVES

- 3) The Health Care Trust's sole and exclusive objective is to provide a funding source for the health and welfare benefits for retirees and dependents of the City of San Jose Police and Fire Department Retirement Plan.
- 4) To achieve the goal detailed above, the Health Care Trust's assets will be managed:
 - a) To achieve a high level of return with a prudent level of risk;
 - b) To provide sufficient liquidity to meet all cash needs;
 - c) To provide sufficient diversification in an effort to avoid significant losses and preserve capital.

FIDUCIARY STANDARDS

- 5) The Board of Administration is subject to the following duties under law:¹
 - a) The assets of the Health Care Trust are trust funds and shall be held for the exclusive purposes of providing benefits to members of the Plan and their beneficiaries and defraying reasonable expenses of administering the Health Care Trust.
 - b) The Board shall discharge their duties with respect to the Health Care Trust solely in the interest of, and for the exclusive purposes of providing benefits to, members of the Plan and their beneficiaries, and defraying reasonable expenses of administering the Health Care Trust. The Board's duties to the members and their beneficiaries shall take precedence over any other duty.
 - c) The Board 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.
- 6) Investment staff, investment consultants, investment managers, custodians and all other parties charged with handling the Health Care Trust'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.

FUND GOVERNANCE

- 7) The governance structure of the Health Care Trust 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

¹ Per section 540 of Chapter 3.36, 1961 Police and Fire Department Retirement Plan.

- 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 long-term asset allocation of the Health Care Trust will be determined based on the results of an asset allocation study.
- 9) The current asset allocation policy of the Health Care Trust (at market value) as of 12/31/2012 is set out below:

San Jose Police and Fire Retiree Health Care Trust Fund			
<i>Broad Asset Class</i>	<i>Minimum (%)</i>	<i>Target (%)</i>	<i>Maximum (%)</i>
Equity	25	43	50
Fixed Income	20	35	40
Inflation-Linked	12	22	25
Cash	0	0	5
Total		100	

- 10) The Board is 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.
- 11) The long-term asset allocation of the Health Care Trust will be reviewed at a minimum every five years, also based on the results of an asset allocation study. Such studies may also be performed on an interim basis, as necessary. The Board may review the current asset allocation targets at any time in light of market conditions, and make changes as it deems necessary.
- 12) The Board 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. The Investment Structure and any changes thereto do not necessarily require that an asset allocation study be performed.

REBALANCING

- 13) The asset allocation of the Health Care Trust will be monitored on a monthly basis and the assets of the Health Care Trust are to be rebalanced 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.
- 14) 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 the allocation is within the guideline ranges.

DIVERSIFICATION

- 15) 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.
- 16) Consistent with paragraph 15 above:
 - a) No single investment management firm shall be authorized to manage more than 15% of the Health Care Trust's actively managed assets without Board approval. There is no limit on the amount of passively managed assets that an investment management firm shall be authorized to manage.
 - b) As a general rule, Health Care Trust assets placed with an investment manager should not represent more than 10% of the total assets managed by that firm, without Board approval.

LIQUIDITY MANAGEMENT

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

PROXY VOTING

- 18) Proxies must be voted in the best interest of shareholders — in this case the Health Care Trust and its members and beneficiaries. The Health Care Trust may engage the services of one or more third parties, including but not limited to its custodian, investment managers, and consultants, to vote proxies for common stocks owned in its portfolios. Such parties must exercise their authority to vote as fiduciaries to the Health Care Trust and in accordance with applicable standards of prudence. The Board may establish proxy voting guidelines to further guide the voting of the Health Care Trust's proxies. Any third parties retained to vote the proxies of the Health Care Trust shall provide periodic reports to the Health Care Trust on their activities.
- 19) As of the date of this Policy, the Board has delegated its proxy voting authority on all domestic securities to a dedicated proxy voting advisor. Investment managers for international securities are responsible for voting the proxies on international securities, as are hedge fund managers.

HIRING & TERMINATING INVESTMENT MANAGERS

- 20) 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 Health Care Trust.

- 21) Staff-level procedures shall be prepared detailing the additional criteria and processes to be used in conducting investment manager due diligence and in arriving at recommendations to select or terminate an investment manager. Such procedures shall be reviewed with the Investment Committee and the Board from time to time.
- 22) The procedures noted in paragraph 21 above shall require at a minimum that recommendations to appoint or terminate an investment manager shall be accompanied by a report, prepared by an external investment advisor and/or investment staff, containing investment staff's and/or the investment advisor's recommendations and summary analysis.

MONITORING INVESTMENT MANAGERS

- 23) The Health Care Trusts's investment managers will be monitored on an ongoing basis and may be terminated by the Health Care Trust 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 Health Care Trust.
- 24) The majority of the Health Care Trust'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.
- 25) 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 Health Care Trust.
 - b) Loss of an investment professional(s) directly responsible for managing the Health Care Trust'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 Health Care Trust's assets at undue risk of loss.

DERIVATIVE SECURITIES

- 26) 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.

- 27) In general, the use of derivatives for the purposes noted above, and similar risk management purposes, is supported by the Investment Committee and the Board. Speculative positions in derivatives, however, are not authorized under any circumstances.
- 28) Given the nature of many investment managers' mandates, it is recognized and understood that investment managers retained by the Health Care Trust may use derivatives that are contrary to paragraphs 26 and 27 above.
- 29) This policy allows for the use of derivatives within the specific portfolios being managed by the investment managers retained by the Health Care Trust. Use of derivatives at the Health Care Trust level (i.e. Total Fund) must be authorized by this Investment Policy Statement prior to being utilized within the Health Care Trust.

INVESTMENT RESTRICTIONS

- 30) Health Care Trust assets are currently invested primarily in mutual fund investment vehicles, given the current asset size of the Health Care Trust. The type of investment vehicles utilized by the Health Care Trust will be revisited as the asset size of the portfolio increases. In instances when the Health Care Trust invests through a commingled fund or separate account, investment management agreements will be established for each investment manager retained by the Health Care Trust. 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

- 31) Investment costs shall be monitored, controlled, and whenever possible negotiated to ensure cost effectiveness.² The Board shall give consideration to the impact of administrative expenses, external management fees and performance fees when establishing the asset mix policy of the Health Care Trust.
- 32) The Board will be provided reports on investment costs of the Health Care Trust at least annually.

VALUATION OF INVESTMENTS

- 33) The Health Care Trust'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.
- 34) 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

- 35) Appendix A contains the Long-term Policy Benchmark.
- 36) Exceptions to this Investment Policy Statement must be approved by the Board of Administration of the Health Care Trust.

² Monitor all costs of alternative investments, given that many alternative investments report performance net of fees.

POLICY REVIEW & HISTORY

37) This policy will be reviewed at least annually.

38) This policy was most recently reviewed by the Investment Committee on June 6, 2013.

APPENDIX A

Long-term Policy Benchmark

City of San Jose Police and Fire Department Retirement Plan Retiree Health Care Trust Fund		
Asset Class	Benchmark	Target (%)
Equity	MSCI ACWI IMI (Net)	43%
Fixed Income	BC Aggregate	35%
Inflation-Linked	MSCI U.S. REIT	10%
	Credit Suisse Custom Risk Parity Commodity Index	12%