

CITY AND COUNTY OF SAN FRANCISCO
RETIREE HEALTH CARE TRUST FUND

D R A F T

INVESTMENT POLICY STATEMENT

Adopted
May 22, 2014

Updated

I. Introduction

The City and County of San Francisco Retiree Health Care Trust Fund (“RHCTF” or “Fund”) was created in 2009 for the sole and exclusive purpose of providing a funding source to defray the cost of the City’s, and other Participating Employer’s, obligations to pay for ~~Health and Welfare Benefits for Retirees~~ health coverage for Retired Persons and their eligible spouses, registered domestic partners, dependents and survivors entitled to health care coverage under Charter Section A8.428.

The San Francisco Retiree Health Care Trust Fund Board (Board) is the governing fiduciary for the ~~RHCTF~~ Fund, and, as such, is charged with governing the RHCTF.

The purpose of this Investment Policy Statement (“IPS”) is to set forth the goals, objectives, and investment constraints of the ~~RHCTF~~ Fund, and to establish guidelines for the implementation of investment strategy.

II. Investment Goals

The Board recognizes that a stable, well-articulated investment policy is crucial to the long-term success of the ~~RHCTF~~ Fund. As such, the Board has developed this IPS with the following goals in mind:

- To clearly and explicitly establish the objectives and constraints that govern the investment of ~~the RHCTF’s~~ Fund assets;
- To establish a long-term target asset allocation with a likelihood of meeting ~~the RHCTF’s~~ Fund goals and objectives, given the explicit investment constraints;
- To protect the financial health of the ~~RHCTF~~ Fund; and
- To clearly articulate duties of responsible parties.

III. Fiduciary Standards

- a. As Trustees of the ~~RHCTF~~ Fund, Board members are fiduciaries. The Board operates under the “RHCTF Board Fiduciary Policy”, and intends to act in accordance with that Policy in the context of exercising its investment responsibilities. Accordingly, Board members must:
 - i. Act solely in the interest of ~~the RHCTF’s~~ Fund participants and beneficiaries, for the exclusive purpose of providing benefits and defraying the reasonable costs of managing ~~the RHCTF’s~~ Fund assets.
 - ii. ~~exercise~~ Exercise the care, skill, prudence and diligence that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims. -

- iii. Diversify the investments of the ~~RHCTF~~Fund in order to minimize the risks of meaningful losses, unless under the circumstances it is clearly prudent not to do so.
- iv. Act in accordance with ~~RHCTF's~~the Fund authorizing statute, Charter sections 12.204 and A8.432, and governing documents.
- b. Fiduciary standards of conduct also apply to ~~the RHCTF's~~Fund staff, investment managers, custodians, investment consultants, and others who exercise discretionary authority or control over the management or disposition of ~~the RHCTF's~~Fund assets.

IV. Duties and Responsibilities

a. ~~Board.~~

~~a.~~ The Board is responsible for establishing the policies and guidelines by which the ~~RHCTF~~Fund is managed.

b. ~~Investment Managers.~~

~~b.~~ The Board may employ professional investment managers to give them the discretion to manage ~~the RHCTF~~Fund assets. Each investment manager will operate under a formal contract, which will include, but is not limited to, an outline of the strategy they have been hired to manage, performance expectations, and investment guidelines. The Board will periodically review the investment managers against their stated objectives.

c. ~~Investment Consultant.~~

~~c.~~ The Board may retain an Investment Consultant to assist in performance review, asset allocation decisions, manager due diligence, and investment recommendations. The recommendations of the Investment Consultant may be considered by the Board in conjunction with other available information for the purpose of making informed and prudent decisions.

d. ~~Custodian Bank.~~

~~d.~~ The Custodian Bank holds the assets of the ~~RHCTF~~Fund. The Custodian Bank accounts for, and assists in, the settlement and transfer of assets by investment managers and ~~the RHCTF~~Fund Staff. The Custodian Bank is expected to provide the ~~RHCTF~~Fund with timely information as related to portfolio holdings, transactions, and performance.

V. **Investment Objectives**

The investment strategy of the ~~RHCTF~~Fund is designed to ensure the prudent investment of funds in such a manner as to provide real growth of assets over time while protecting the value of the assets from undue volatility or risk of loss.

a. Risk Objectives

- i. The Board recognizes that in order for the ~~RHCTF~~Fund to reach its target rate of return and meet its expected liabilities, the ~~RHCTF~~Fund must allocate a portion of assets to riskier, higher returning assets.
- ii. The ~~RHCTF~~Fund will use diversification to minimize company-specific, industry-specific, country-specific, and other idiosyncratic risks in the aggregate investment portfolio.
- iii. The ~~RHCTF~~Fund will ~~minimize~~monitor liquidity risk, thus maximizing the ~~RHCTF's~~Fund's ability to meet disbursement needs during adverse market conditions. The Board anticipates that liquidity will not be a factor for a long period of time, given the legal structure around the Fund.

b. Return Objectives

- i. In a manner consistent with the goals stated in Section II above, to manage ~~the Fund's~~Fund assets so as to achieve the highest, reasonably prudent real return possible.

VI. Investment Constraints

a. Legal and Regulatory

The Board intends that ~~the RHCTF~~Fund assets be at all times invested in accordance with applicable laws. The Board will retain legal counsel when appropriate to review contracts and provide advice with respect to applicable statutes and regulations.

b. Time Horizon

The ~~RHCTF~~Fund will be managed on a going-concern basis. ~~The~~Fund assets ~~of the RHCTF~~ will be invested with a long-term time horizon (twenty years or more), consistent with the goals stated in Section II above.

c. Liquidity

The Board intends to ~~limit~~monitor the percentage of assets that it will invest in illiquid vehicles, defined as those vehicles that do not allow withdrawals to occur on at least a monthly basis.

d. Tax Considerations

The ~~RHCTF~~Fund is exempt from U.S. federal, state, and local income taxes. Therefore, investments and strategies will be evaluated on a basis of expected risk and return regardless of taxable status, except where the prospect of Unrelated Business Income Tax (UBIT) is a concern.

VII. Diversification

The Board ~~of the RHCTF~~ recognizes that the important element of risk control is diversification. Therefore, investments will be allocated across multiple asset classes, chosen in part for the expected correlation of their returns. Within each asset type, the Board will seek to distribute investments across individual holdings, thus further minimizing volatility. In addition, for appropriate investment managers, investment guidelines will specify diversification requirements, including, but not limited to, the maximum permissible investment in any one asset.

VIII. Asset Allocation

The Board recognizes that the allocation of monies to various asset classes will be the major determinant of the RHCTF's Fund return and risk experience over time. Therefore, the Board intends to allocate investments across those asset classes that, based on historical and expected returns and risks, provide the highest likelihood of meeting the RHCTF's Fund investment objectives. The Board retains the right to choose to invest the Fund assets ~~of the RHCTF~~ alongside similar investors, ~~in a pre-determined asset allocation structure.~~ The Board acknowledges that, due to the size of the RHCTF Fund assets, certain asset classes may not be investable until such time as the Fund becomes large enough to: (a) meet minimum investment criteria; or (b) accept the illiquidity risk associated with such investments.

a. Permissible Asset Classes

Because investment in any particular asset class may or may not be consistent with the Fund objectives ~~of the RHCTF~~, the Board has specifically indicated in Appendix A those asset classes that may be utilized when investing the RHCTF Fund assets.

b. Expected Returns, Risks, and Correlations for Permissible Asset Classes

The risk and return behavior of the RHCTF Fund will be driven primarily by the allocation of investments across asset classes. In determining the appropriate allocation, the expected return and risk behavior of each asset class and the likely interaction of various asset classes in a portfolio are to be considered. Appendix B lists the expected return, volatility, and correlations for each permissible asset class.

c. Long-Term Target Allocations

Based on the investment objectives and constraints of the RHCTF Fund, and on the expected behavior of the permissible asset classes, the Board will specify a long-term target allocation for each class of permissible assets. These targets will be expressed as a percentage of the RHCTF's Fund's overall market value, surrounded by a band of permissible variation resulting from market forces.

The long-term target allocations are intended as strategic goals, not short-term imperatives. Thus, it is permissible for the overall ~~RHCTF's~~ Fund asset allocation to deviate from the long-term target, as would likely occur during manager transitions, asset class restructurings, and other temporary changes in the ~~RHCTF~~ Fund. Deviations from targets that occur due to capital market changes are discussed below.

The ~~RHCTF's~~ Fund's target allocations for all permissible asset classes are shown in Appendix C.

d. Rebalancing

In general, cash flows to and from the ~~RHCTF~~ Fund will be allocated in such a manner as to move each asset class toward its target allocation.

The Board recognizes that, periodically, market forces may move ~~the~~ ~~RHCTF's~~ Fund allocations outside the target ranges. The Board also recognizes that failing to rebalance the allocations would unintentionally change the ~~RHCTF's~~ Fund's structure and risk posture. Consequently, the Board has established the following process to rebalance the allocations periodically.

On at least an annual basis, if any strategic allocation is outside the specified target range, assets will be shifted to return the strategy to within the target range. The specific plan for rebalancing will identify those assets that can be shifted at the lowest possible risk and cost, if the rebalancing cannot be accomplished solely by allocating contributions and withdrawals.

IX. Review of Investment Policy, Asset Allocation, and Performance

The Investment Policy Statement will be reviewed at least annually to ensure that the objectives and constraints remain relevant. However, the Board recognizes the need for a stable long-term Fund policy ~~for the San Francisco Retiree Health Care Trust Fund~~, and thus, in general, major changes to ~~this policy statement will~~ the Investment Policy Statement should only be made ~~only~~ when significant developments in the circumstances, objectives, or constraints of the ~~RHCTF~~ Fund occur.

The Fund's asset allocation and investment structure ~~of the RHCTF~~ will be reviewed on an on-going basis, and at least annually. When necessary, such reviews may result in a rebalancing of asset allocation. In general, the Board intends that the ~~RHCTF~~ Fund will adhere to its long-term target allocations, and that major changes to these targets ~~will~~ should be made only in response to significant developments in the circumstances, objectives, or constraints of the ~~RHCTF~~ Fund or in the capital market opportunities.

The Board will specifically evaluate ~~the~~ Fund performance ~~of the RHCTF~~ relative to its objectives and to the returns available from the capital markets during the period under review, within the constraints created by size and structure. In general, the Board will utilize relative, rather than absolute, benchmarks in evaluating performance. The total

performance of the [RHCTF Fund](#) will be evaluated relative to the investment objectives and constraints identified in this investment policy statement. Specifically, the total Fund performance will be evaluated relative to a “custom benchmark” that weights the returns of available market indices on the basis of the [RHCTF’s Fund’s](#) target investment structure, to assess the implementation of the [RHCTF’s Fund’s](#) investment strategy.

X. Investment Manager/Provider Review

The [RHCTF’s Fund’s](#) investment managers will be reviewed periodically to verify that they remain appropriate for the [RHCTF Fund](#). Each manager’s suitability as ~~an~~ [Fund](#) investment manager ~~for the RHCTF~~ will be judged from a variety of perspectives including, but not limited to, stability and capability of professional staff, adherence to investment disciplines for which the manager was retained, business practices, prudent management of risk, investment performance, and client communication. If an outside structure is utilized to invest the assets, then the provider of the investment fund will be reviewed for consistency with [RHCTF Fund](#) objectives.

The Board acknowledges that so long as the Fund remains invested in asset pools selected by the San Francisco Employees’ Retirement System (“SFERS”) and agreed to by the Board, the Board will not have control over the specifics of who manages the passive pools of assets in which they are invested. Nonetheless, the Board intends to monitor those investments, and can choose to terminate the relationship with SFERS and its underlying managers at any time.

XI. Investment Costs

The Board intends to monitor and control Fund investment costs ~~at every level of the RHCTF:~~

- Professional fees will be negotiated whenever possible; existing fees will be reviewed periodically and re-negotiated, as appropriate.
- Where appropriate, passive portfolios will be used to minimize management fees and portfolio turnover.
- If possible, assets will be transferred in-kind during manager transitions and portfolio restructurings to eliminate unnecessary expenses.
- Managers will be instructed to minimize brokerage, execution, and other costs.

XII. Voting of Proxies

The Board recognizes that the voting of proxies is important to the overall performance of ~~the RHCTF~~ Fund investments. The Board may delegate the responsibility of voting all proxies to the investment manager[s] or a third party. The Board expects that all proxies will be executed in a timely fashion. The Board intends to review the voting actions periodically. The Board retains the right to exercise acquired voting rights at any time.

XIII. Socially Responsible Investments

The Board Recognizes that there may be unique circumstances which require the Board to consider socially responsible investments (or divestment) or other restrictions. The Board intends to consider such matters when appropriate, and when the size of the ~~RHCTF~~ Fund is large enough that separate account mandates could be considered. The Board acknowledges that within commingled accounts or mutual funds, it may not have the ability to direct the specific inclusion or exclusion of securities.

XIV. Forbidden Assets and Strategies

~~Appropriate~~ The Fund's investment consultant may furnish appropriate investment managers retained by the ~~RHCTF may be furnished by the investment consultant~~ Fund with a list of asset types and investment strategies that are forbidden as part of their investment manager guidelines. ~~_____.~~ _____.

APPENDIX A

PERMISSIBLE ASSET CLASSES

Asset Class
Domestic Equity
International Equity
Investment Grade Bonds
Global Equity
U.S. Nominal Bonds
Inflation-linked Bonds
Global Real Estate
Commodities

APPENDIX B

MEKETA INVESTMENT GROUP - 2014 ASSET STUDY
 TWENTY-YEAR, SINGLE ASSET CLASS FORECAST

Asset Class	Expected Return (%)	Volatility (%)
Fixed Income		
Cash Equivalents	2.3	1.0
Investment Grade Bonds	3.5	4.5
TIPS	4.0	7.5
Equities		
US Equity	7.8	18.0
Developed Market Equity	8.5	20.0
Emerging Market Equity	11.2	25.0
Global Equity	8.7	20.0
Real Assets		
Real Estate	7.6	18.0
REITs	7.0	26.5
Commodities	6.0	20.0

**MEKETA INVESTMENT GROUP - 2014 ASSET STUDY
 EXPECTED CORRELATIONS AMONG ASSET CLASSES**

	Investment Grade Bonds	TIPS	U.S. Equity	Developed Market Equity	Emerging Market Equity	Global Equity	Real Estate	REITs	Commodities
Investment Grade Bonds	1.00								
TIPS	0.80	1.00							
U.S. Equity	0.05	0.00	1.00						
Developed Market Equity	0.05	0.15	0.90	1.00					
Emerging Market Equity	0.05	0.15	0.80	0.90	1.00				
Global Equity	0.05	0.10	0.90	0.95	0.90	1.00			
Real Estate	0.20	0.10	0.50	0.45	0.40	0.45	1.00		
REITs	0.15	0.20	0.70	0.70	0.60	0.70	0.80	1.00	
Commodities	0.05	0.35	0.35	0.55	0.60	0.50	0.15	0.30	1.00

APPENDIX C

ASSET ALLOCATION TARGETS

Asset Class	Target	Range	Composite Benchmark
<u>Domestic Equity</u>	<u>37%</u>	<u>32-42%</u>	<u>S&P 500 Index ex Tobacco</u>
<u>International Equity</u>	<u>37%</u>	<u>32-42%</u>	<u>MSCI EAFE Index</u>
<u>Investment Grade Bonds</u>	<u>26%</u>	<u>21-31%</u>	<u>Barclays Aggregate Index</u>

The Asset Allocation targets above have a current long-term expected return of 7.5%, with an expected standard deviation of 13.8% (As of Meketa Investment Group's 2014 Asset Study).