



POST-RETIREMENT HEALTH CARE PLAN
INVESTMENT GUIDELINES DOCUMENT

Adopted June 2008

Merced County Post-Retirement Health Care Plan Investment Guidelines Document

In response to the Government Accounting Standards Board (GASB) Statement Number 45 disclosure requirements for Other Post-Employment Benefit (OPEB) Plans, Merced County has adopted a Section 115 Trust Plan that seeks to satisfy these liabilities for certain eligible employees.

Executive Summary

Plan Sponsor:	Merced County (County)
Oversight Board:	Merced County OPEB Retirement Investment Trust Board (OPEB RITB)
Plan Administrator:	Merced County Assistant County Executive Officer and/or Designee
Trust Administrator:	Public Agency Retirement Systems (PARS)
Trustee:	Union Bank of California, N.A.
Investment Advisor:	HighMark Capital Management (Portfolio Manager)
Investment Authority:	Full Investment Authority
Account Number(s):	To be determined
Current Assets:	\$5 million (initial contribution)
Annual Contributions:	Evaluated annually
Risk Tolerance:	Moderately Aggressive Objective
Time Horizon:	Long-Term
Assumed Earnings Rate:	6%

Investment Objective: The primary objective is to maximize total Plan return, subject to the risk and quality constraints set forth below. The Plan's targeted rate of return is 7.5%. The Investment objective selected is the Moderate Aggressive Objective. The asset allocation ranges for this objective are listed below:

Strategic Ranges: 0 - 20% Cash
30 - 50% Fixed Income
50 - 70% Equity

Communication Schedule: See Portfolio Reporting Requirements

Portfolio Constraints

Income Needs/Cash Flow Required: To be determined annually by the Plan Administrator.

Unique Needs and Circumstances: None Known

MC OPEB RITB: Board of Supervisors Chair or Vice Chair
County Executive Officer
Auditor-Controller
County Counsel
Treasurer-Tax Collector

Plan Administrator: James Brown, Assistant County Executive Officer
and/or Designee JBrown@co.merced.ca.us

HCM Portfolio Manager: Andrew Brown, CFA 415-705-7605 Andrew.Brown@Uvoc.com

HCM Back up -Portfolio Manager: Delbert Chang CFA 415-705-7603 Delbert.Chang@Uvoc.com

UBOC Administrative Officer: John Fulton, 415-273-2508
John.Fulton@Uvoc.com

PARS Senior Vice President: Mitch Barker, 800-540-6369 x116
Mitch.Barker@pars.org

The managing director for HighMark Capital Management is Kevin Rogers, he can be reached at 949-553-2580

OPEB Retirement Investment Trust Board: _____ **Date:** _____

HCM Portfolio Manager: _____ **Date:** _____

UBOC Administrative Officer: _____ **Date:** _____

OVERVIEW

The purpose of this Investment Guidelines document (IGD) is to assist the OPEB RITB and the Portfolio Manager in effectively supervising, monitoring and evaluating the investment of the County's Post-Retirement Health Care Plan portfolio. The investment program is defined in the various sections of the IGD by:

1. Stating in a written document the OPEB RITB's attitudes, expectations, objectives and guidelines for the investment of all assets.
2. Setting forth an investment structure for managing the County's portfolio. This structure includes various asset classes, investment management styles, asset allocation and acceptable ranges that, in total, are expected to produce an appropriate level of overall diversification and total investment return over the investment time horizon.
3. Encouraging effective communications between the OPEB RITB and the Portfolio Manager.
4. Complying with all applicable fiduciary, prudence and due diligence requirements experienced investment professionals would utilize, and with all applicable laws, rules and regulations from various local, state, and federal entities that may impact the County's assets.

COUNTY OPEB RETIREMENT INVESTMENT TRUST BOARD AND COUNTY PLAN ADMINISTRATOR'S RESPONSIBILITIES

1. The oversight of the investment portfolio.
2. Providing the portfolio manager with all relevant information on the Plan, and shall notify him/her promptly of any changes to this information.
3. Advising the portfolio manager of any change in the Plan's circumstances, such as a change in the actuarial assumptions, which could possibly necessitate a change to the overall risk tolerance, time horizon or liquidity requirements; and thus would dictate a change to the overall investment objective and goals for the portfolio.
4. Monitoring performance by means of regular reviews to assure that objectives are being met and that the policy and guidelines are being followed.

INVESTMENT MANAGERS' RESPONSIBILITIES, POLICIES AND GUIDELINES

All investment managers hired by the OPEB RITB will be registered investment advisors with the Securities and Exchange Commission, or will be trust companies that are regulated by State and Federal Banking authorities. Such investment managers will maintain proper and adequate insurance coverage including errors & omissions, surety bond, and fiduciary liability. In addition, the OPEB RITB's investment managers agree to notify the OPEB RITB and Plan Administrator in writing if they are unable to continue acting in the capacity of a fiduciary or investment advisor.

Investment Manager Responsibilities

The portfolio manager is expected to manage the County's portfolio in a manner consistent with this Investment Guidelines document and in accordance with State and Federal law and the Uniform Prudent Investor Act. The portfolio manager is a registered investment advisor and shall act as such until the OPEB RITB decides otherwise.

The portfolio manager shall be responsible for:

1. Designing, recommending and implementing an appropriate asset allocation consistent with the investment objectives, time horizon, risk profile, guidelines and constraints outlined in this statement.
2. Advising the OPEB RITB and Plan Administrator about the selection of and the allocation of asset categories.
3. Identifying specific assets and investment managers within each asset category.
4. Monitoring the performance of all selected assets.
5. Recommending changes to any of the above.
6. Periodically reviewing the suitability of the investments, being available to meet with the OPEB RITB and Plan Administrator at least once each year, and being available at such other times within reason at the OPEB RITB's request.
7. Preparing and presenting appropriate reports.
8. Informing the OPEB RITB and Plan Administrator if changes occur in personnel that are responsible for portfolio management or research.

Investment Manager Policies

The investment policies governing each investment manager hired by the OPEB RITB are as follows:

1. The investment manager is required to accept the responsibilities stated above. These responsibilities include acting as a prudent expert and agreeing to be a fiduciary to the OPEB RITB. The manager will seek to satisfy the OPEB RITB's investment objectives. If a problem exists with these objectives, it is the manager's responsibility to formally discuss these problems in a written communication to the OPEB RITB and Plan Administrator. Also, the manager agrees to satisfy the OPEB RITB's prescribed reporting requirements in a subsequent section.
2. Under any and all capital market environments, the investment manager agrees to maintain the investment approach that it was hired to implement. Significant changes to the manager's investment decision making process are to be immediately reported in writing to the OPEB RITB and Plan Administrator. On-going introspective research of the firm's investment process, analytics, inputs, and decision-making process will be regularly explained in writing to the OPEB RITB. It is the responsibility of the investment manager to fully educate the OPEB RITB and Plan Administrator as to the specifics of its investment process and internal research that may lead to changes in the firm's investment approach.
3. An investment portfolio constructed for the OPEB RITB is expected to generally conform to other portfolios managed by the investment organization, exclusive of specific investment guidelines. When the OPEB RITB's guidelines require the investment manager to manage a portfolio significantly different than its other portfolios, it is the responsibility of the manager to communicate in writing the potential impact of the OPEB RITB's guidelines on the portfolio.
4. The manager will otherwise treat the County's portfolio in a manner similar to other comparable portfolios in portfolio construction trading, and all other aspects.

5. Portfolios managed for the OPEB RITB are fully discretionary, but must meet the provisions of the OPEB RITB's investment objectives and policies. Investment guidelines also exist for each investment manager within the major asset classes.
6. Unless otherwise specified, portfolios are to be fully invested in allowable investment securities. Under no circumstance shall an investment manager attempt to "market time" investments in its portfolio(s).

PORTFOLIO REPORTING REQUIREMENTS

Reports to the OPEB RITB and Plan Administrator shall include the following information and cover these stated topics:

Quarterly Reports:

Portfolio investment objectives, investment strategy and decision making process:

1. The investment objectives of the portfolio will be clearly stated. Next, a narrative description of the portfolio's investment strategy will be provided, with a discussion of the factors that proved to be favorable and those that were unfavorable. In addition, a concise statement of the firm's investment decision making process will be provided and any changes or modifications that were made to the process.
2. Portfolio performance before and after investment management fees:
The manager shall report the quarterly total portfolio rate of return before and after investment management fees have been deducted, as well as cumulative and annual performance on both bases since account inception. Also included in these tables will be the manager's performance benchmarks.
3. Portfolio asset mix and asset growth:
The portfolio's allocation to the major asset classes will be specified for the beginning and end of the quarter. Market values will be shown for the total account over the same period.
4. Portfolio allocations according to characteristics and other classifications:
Specific portfolio characteristics will be developed and contrasted to those of the portfolio's performance benchmark.
5. Portfolio reconciliation to the custodial bank:
As of month end, the investment manager will reconcile their portfolio market value to that provided by the custodial bank. The custodial trustee accounts for investments on a trade date, full accrual basis. Explanation of any discrepancies shall be provided to the OPEB RITB.
6. Portfolio positions and transactions:
Individual issues in the portfolio as of the most recent quarter-end shall be provided, as well as a list of portfolio purchases and sales. Securities that are sold will be classified according to the manager's general reasons for sale.

Monthly Reports:

Portfolio summary report and detailed positions and transactions:

1. A summary report consisting of a statement of changes in market value from the preceding month, a summarized portfolio composition using market values and portfolio performance for the latest month, and a portfolio reconciliation to the custodial market value of the account. The report should also include individual issues in the portfolio as of the most recent month-end along with a list of portfolio purchases and sales.

PORTFOLIO REBALANCING

1. From time to time, market conditions may cause the OPEB RITB asset allocation to vary from the established target. To remain consistent with the asset allocation guidelines established by this Investment Guidelines document, the Portfolio Manager will at a minimum rebalance the portfolio on a quarterly basis.
2. The OPEB RITB and Plan Administrator has authority to issue instructions to the portfolio manager to liquidate securities for reallocation to other managers.
3. On an annual basis, the OPEB RITB and Plan Administrator shall develop a cash flow plan for the subsequent year. This plan will take into consideration expected cash needs both for the payment of benefits as well as to fund under-allocated or new asset classes.

ASSET ALLOCATION PLAN AND TARGET ASSET MIX

Based on the OPEB RITB's asset allocation study and acceptance of the proposed target asset mix, the following is the OPEB RITB's target asset mix and allocation ranges. The OPEB RITB will review its asset allocation position as needed or a minimum of once every three to five years.

The Portfolio Manager is responsible for maintaining the balance between fixed income and equity securities based on the asset allocation. The following parameters shall be adhered to in managing the portfolio:

	<u>Target Mix</u>	<u>Allocation Ranges</u>	
		<u>Minimum</u>	<u>Maximum</u>
Total Domestic Equity	45%	30%	50%
Large Cap	35	30	50
Mid Cap	0	0	20
Small Cap	10	0	20
International Equity	10	0	20
Domestic & Global Real Estate	5	0	10
Domestic Fixed Income	35	30	50
Short-Term Investments	5	0	20

The market benchmarks for the above asset classes are as follows:

Large Cap Equity	Russell 1000
Small Cap Equity	Russell 2000, Russell 2000 Growth or Value
International Equity	Europe, Australia, & Far East Index (EAFE)
Real Estate	Dow Jones Wilshire REIT Index
Domestic Fixed Income	Lehman Aggregate Bond Index
Short-Term Fixed Income	90-Day Treasury Bills
Total Fund Benchmark	Target asset mix percentages are applied to individual asset class benchmarks to arrive at the total fund benchmark.

Permitted Asset Classes and Security Types

The following asset classes and security types have been approved by Manager for use in OPEB RITB portfolios:

Asset Classes

- Fixed Income
 - Domestic Bonds
 - Non-U.S. Bonds
- Equities
 - Domestic
 - Non-U.S.
 - Emerging Markets
 - Real Estate Investment Trust (REITs)
- Cash and Cash Equivalents

Security Types

- Equity Securities
 - Domestic listed and unlisted securities
 - Equity and equity-related securities of non-US corporations, in the form of American Depository Receipts (“ADRs”)
- Equity Mutual Funds
 - Large Cap Growth and Value
 - Mid Cap Core
 - Small Cap Growth and Value
 - International and Emerging Markets
 - REITs
- Exchange Traded Funds (ETFs)
- Fixed Income Securities
 - Government/Agencies
 - Mortgage Backed Bonds
 - Corporate Bonds and Notes
 - Unit Trusts
- Fixed Income Mutual Funds
 - Corporate
 - Government
 - High Yield
 - International and Emerging Market
 - Convertible
 - Preferred
- Closed end funds
- Cash and Cash Equivalents
 - Money Market Mutual Fund
 - Commercial Paper
 - CDs and Bankers Acceptance

Prohibited assets

While the Plan will not invest in any of the prohibitive investments directly, which are listed below, it is understood that the commingled investment funds, both mutual funds and index funds that the Plan invests in, might have exposure to such types of investments.

- Precious metals
- Venture Capital
- Short sales
- Purchases of Letter Stock, Private Placements, or direct payments
- Leveraged Transactions
- Commodities Transactions Puts, calls, straddles, or other option strategies,
- Purchases of real estate, with the exception of REITs
- Derivatives, with exception of ETFs

Duties of Responsibilities

Funds selected as investments in the Plan will be expected to have undergone a rigorous screening process that searches for managers and styles that will produce above average returns within acceptable risk parameters. The evaluation process will consider the following factors:

- Performance track record
- Fund assets
- Manager tenure with fund
- Expense ratios
- Market capitalization
- Style consistency
- Number of holdings
- Assets in top 10
- Portfolio turnover
- Sector weighting allocations
- Standard deviation
- Sharpe ratio

Performance evaluation of the Funds will take into consideration both performance relative to a benchmark index as well as performance relative to a universe of the fund's peers. Evaluation metrics versus a representative benchmark will utilize a twelve-month rolling performance record compared to a representative benchmark over a three, five, seven and ten-year period (if available).

A fund is expected to rank above the median in its appropriate peer group for the three, five, and ten-year periods (if available).

An additional requirement for all funds utilized in the Plan is that the fund families that sponsor the funds will have filled out and returned a request for proposal (RFP) submitted to them by the investment manager. This RFP will highlight significant areas such as organizational factors, composition of assets, portfolio characteristics, investment process, fee structure, internal compliance controls, and an overview of the investment personnel.

Investment mutual funds may be removed from the investment portfolio from time to time. Factors that the investment manager will consider in regards to removing a fund include, but is not limited to:

- Performance that is inconsistent with the manager's style or our expectations
- Performance that conflicts with peers and style universes
- Security selection not in agreement with the manager's investment philosophy/process
- Purchases that lead to abnormal portfolio concentrations
- Sector and industry exposures that are inconsistent with the manager's guidelines
- Unusual tracking error to the benchmarks
- Inadequate transparency between the manager's comments and portfolio holdings
- Inconsistencies related to the manager's remarks on style, sector, and market cap weightings
- Instability at the manager's investment management firm
- Modifications to the investment process and/or risk controls that interfere with a firm's strategy
- Staffing adjustments that may result in poor performance

Communication

As a matter of course, the portfolio manager shall keep the OPEB RITB apprised of any material changes in the Manager's outlook, recommended investment policy and tactics. In addition, the portfolio manager shall meet with the OPEB RITB no less than annually to review and explain the portfolio's investment results and any related issues. The portfolio manager shall also be available on a reasonable basis for telephone communication when needed.

Any material event that affects the ownership of Manager's management of the portfolio must be reported immediately to the OPEB RITB.