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CITY OF BERKELEY

INVESTMENT POLICY

FOR RETIREE MEDICAL PLAN TRUST FUNDS

Effective July 1, 2022

Public

City of Berkeley
INVESTMENT POLICIES FOR RETIREE MEDICAL PLAN TRUST FUNDS
July 1, 2022

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I. INTRODUCTION

Pursuant to Sections 2.44.040 and 2.44.060 of the Berkeley Municipal Code, Resolution No. 45,087-N.S., and Sections 53601, 53607, 53636 and 53648 of the State Government Code, the Director of Finance, the Treasurer of the City, is authorized to make investments of the City's idle funds. The Code also directs the City to present an annual investment policy to the City Council for approval. This Investment Policy, after approval of the amendments by the City Council, will serve as the Investment Policy for the City of Berkeley for the subsequent fiscal year.

Notwithstanding Section 53601 or 53635, the governing body of a local agency may invest funds designated for the payment of employee retiree health benefits in any form or type of investment deemed prudent by the governing pursuant to Section 53622. The authority of the governing body to invest or to reinvest funds intended for the payment of employee retiree health benefits, or to sell or exchange securities purchased for that purpose, may be delegated by the governing body to designated officers. The City Council has designated the Director of Finance, the Treasurer of the City, or his/her designee, the authority to make investments of the City's retiree medical plan trust funds.

Funds intended for the payment of employee retirement health benefits shall only be held for the purpose of providing benefits to participants in the retiree health benefit plan and defraying reasonable expenses of administering that plan.

The governing board or designated officer, when making investments of the funds, shall discharge its duties with respect to the investment of the funds.

(1) Solely in the interest of, and for the exclusive purposes of providing benefits to, participants in the retiree health benefit plan, minimizing employer contributions thereto, and defraying reasonable expenses of administering the plan.
(2) With 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 a like character and with like aims.
(3) Shall diversify the investments of the funds so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is clearly prudent not to do so.

A. SCOPE OF POLICIES

These investment policies apply to the investments of the Retiree Medical Plan Trust Funds.

B. INVESTMENT OBJECTIVES

The Treasurer adheres to the principle which maintains that over the long-term, prudent investment risk-taking may be rewarded with higher incremental returns. Consequently, while capital preservation (i.e., Safety) is regarded to be of paramount importance, the Treasurer regards prudent risk-taking as justifiable.

C. USE OF STATE INVESTMENT GUIDELINES

As required under Government Code Sections 16481.2 and 53646, the Statement of Investment Policies will be reviewed by the Council annually.

II. INVESTMENT AUTHORITY AND RESPONSIBILITIES

A. AUTHORIZED INVESTMENT OFFICERS

1. Retiree Medical Trust Funds:

A Trust is to be established by the City for the purpose of holding and investing assets separate and apart from the other funds of the City to fund the benefits of the Program. The specific terms governing the Trust are to be set forth in a separate trust instrument.

- The trustee of the Trust (the "Trustee") may be the City Treasurer (i.e., Director of Finance) or an independent third party qualified to act as a trustee under California law and designated by the City.

- The Trustee shall be a fiduciary of the Program and shall act solely in the interest of the Participants, minimizing employer contributions to the Trust, and defraying reasonable expenses of administering the Program.

- The City Manager may, with the written concurrence of the City Council, appoint an "investment manager" (as that term is defined in section 3(38) of the Employee Retirement Income Security Act) to have responsibility for investment of the Trust assets. In this case, the Trustee shall act as directed by the investment manager. The investment manager shall act as a fiduciary of the Program and shall act with the same duties and responsibilities set out in "Investment Objectives" section above.

B. INTERNAL CONTROLS

The Director of Finance shall establish a system of internal controls designed to prevent losses of trust funds arising from fraud, employee error, misrepresentation of third parties, unanticipated changes in financial markets, or imprudent actions by employees and officers of the City of Berkeley. The concept of reasonable assurance recognizes that (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the valuation of costs and benefits requires estimates and judgments by management. These controls shall include:

- Separation of transaction authority from accounting and physical custody.
- By separating the person who authorizes or performs the transaction from the people who record or otherwise account for the transaction, a separation of duties is achieved.
- Also, securities purchased from any bank or dealer including appropriate collateral (as defined by State Law), shall be placed with an independent third party for custodial safekeeping.
- Avoidance of physical delivery of securities by using a delivery versus payment "Basis

of Settlement Only".

- All trades will be executed on a delivery versus payment (DVP) basis. This ensures that securities are delivered to the City's safekeeping bank at the same time the funds are released by the City's safekeeping bank.
- Third-Party custodial safekeeping of securities held in the name of the City. Delivered securities must be properly safeguarded against loss or destruction. Book entry securities are recorded in electronic records and the potential for fraud and loss increases with physically delivered securities. All investment securities, except collateralized certificates of deposit and money market funds, purchased by the City will be delivered by either book entry or physical delivery and will be held in third-party safekeeping by a City-approved custodian bank, its correspondent New York Bank or the Depository Trust Corporation (DTC). Whenever possible, securities purchased are to be recorded in "book entry" form.
- All securities and applicable collateral will be held by the City's third party custodian and evidenced by safekeeping receipts. All book entry securities owned by the City shall be evidenced by a safekeeping receipt issued to the City by the custodian bank to acknowledge that the securities are held in the Federal Reserve system in a "customer account" for the custodian bank which names the City as "customer";

The Director of Finance will require each approved safekeeping financial institution to submit a copy of its Consolidated Report of Condition and Income (Call Report) to the City within 60 days after the end of each calendar quarter.

- Competitive bidding on investment transactions. Before the City invests in any secondary market funds, competitive bids shall be requested. If a specific maturity date is required, either for cash flow purposes or for conformance to maturity guidelines, bids will be requested from at least three financial institutions for instruments which meet the maturity requirement. If no specific maturity is required, a yield curve analysis will be conducted to determine which maturities would be most advantageous.
- Written confirmation and documentation of all financial transactions.
- Due to the potential for error and improprieties arising from telephone transactions, all telephone transactions should be supported by written communications and approved by the appropriate person. Written communications may be via fax if on letterhead and the safekeeping institution has a list of authorized signatures.
- Rapid deposit of funds received by the City (i.e., large checks.)
- Bonding of all investments officials.

C. EVALUATION OF INVESTMENT OFFICER ACTIONS

Section 53600.3 of the Government Code identifies trustees as those persons authorized to make investment decisions on behalf of a local agency. As a trustee, the standard of prudence to be used by investment officials shall be the "prudent investor" standard and shall be applied in the context of managing an overall portfolio. Investment officers acting in accordance with written procedures, and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided deviations from expectations

are reported in a timely fashion and the liquidity and the sale of securities are carried out in accordance with the terms of this plan.

Investments shall be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived.

Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with the proper execution and management of the investment program, or that could impair their ability to make impartial decisions. Employees and investment officials shall disclose any material interests in financial institutions with which they conduct business. They shall further disclose any personal financial/investment positions that could be related to the performance of the investment portfolio. Employees and officers shall refrain from undertaking personal investment transactions with the same individual with whom business is conducted on behalf of their entity.

III. CAPITAL PRESERVATION AND RISK

A. OVERVIEW

The Treasurer adheres to the principle which maintains that over the long-term, prudent investment risk-taking may be rewarded with higher incremental returns. Consequently, while capital preservation (i.e., Safety) is regarded to be of paramount importance, the Treasurer regards prudent risk-taking as justifiable.

Some level of risk is inherent in any investment transaction. Losses may be incurred due to issuer default, market price changes, or technical cash flow complications such as investments in non-marketable certificates of deposit. Diversification of the City's portfolio by institution, investment vehicle, and maturity term is the primary tool available to the City in minimizing investment risk and capital losses by safeguarding the overall portfolio from any individual loss.

B. PORTFOLIO DIVERSIFICATION PRACTICES

The following sections summarize the City's major portfolio diversification practices and guidelines in determining:

- Authorized Dealers
- Investment Vehicles
- Investment Maturity

Portfolio limitations included in these guidelines are to be based on the portfolio composition and investment management plan policies in effect at the time of placement; the actual composition of the City's investments may vary over time from plan limitations due to overall portfolio changes from when the individual placement was made as well as changes in the City's investment management plan.

IV. ELIGIBLE FINANCIAL INSTITUTIONS

A. AUTHORIZED DEALERS

- Investments shall be purchased only through well-established, financially sound institutions. The Finance Director shall maintain a list of financial institutions and broker/dealers approved for investment. All financial institutions and broker/dealers who desire to become qualified bidders for investment transactions will be given a copy of the City's Statement of Investment Policies, and a return cover letter which must be signed indicating that the Statement of Investment Policies has been read and understood.

  Qualified financial institutions and broker/dealers must supply the Director of Finance with the following:

  Financial Institutions
  Current audited financial statements
  Depository contracts, as appropriate
  A copy of the latest FDIC call report or the latest FHLBB report, as appropriate.

  Broker/Dealers
  Current audited financial statements
  Proof that brokerage firm is a member in good standing with a national securities exchange.

- Except for repurchase agreements, investments shall be awarded based on competitive bids. Documentation relating to investment quotes shall be maintained by the Finance Department for a period of one year.

B. INDIVIDUAL PLACEMENT OF DEPOSITS

Individual placement of negotiable, collateralized, and other time certificates of deposit with eligible financial institutions shall be based on the following practices and procedures:

- Deposits shall only be placed with financial institutions maintaining offices within the City of Berkeley.
- Unless collateralized by eligible securities as provided in Sections 53651 and 53652 of the Government Code, the maximum amount of Certificates of Deposit to be placed with any single institution is $250,000.

V. INVESTMENT VEHICLES

The governing body of a local agency may invest funds designated for the payment of employee retiree health benefits in any form or type of investment deemed prudent by the governing pursuant to Section 53622. Some of the investment vehicles the City Council has authorized are the following:

1. **U.S. Treasury Instruments**
   As authorized in Government Code Section 53601(b), this category includes bills, notes, bonds or certificates of indebtedness, or those for which the faith and credit of the United States are pledged for the payment of principal and interest. There are no portfolio limitations on the amount.

2. **Government Sponsored Enterprises**
   As authorized in Government Code Section 53601(f), this category includes a wide variety of government securities. These securities include U. S. government-sponsored enterprise obligations, such as issues by the Federal National Mortgage Association (FNMA's), Federal Home Loan Bank (FHLB), Federal Farm Credit (FFCB), Student Loan Marketing Association (SLMA), etc. There are no portfolio limitations on the amount.

3. **Municipal Securities**
   As authorized in Government Code Section 53601(a)(c)(d)(e), this category includes obligations of the City, the State of California, any of the other 49 states, and any local agency within the State of California, provided that:
   - The securities are rated "A" or higher by at least one nationally recognized statistical rating organization.
   -
   - There are no limitations on the amount or period.

4. **Banker's Acceptances**
   As provided in Government Code Section 53601(f)g, 40% of the City's portfolio may be invested in Banker's Acceptances, otherwise known as bills of exchange or time drafts that are drawn on and accepted by a commercial bank, although no more than 30% of the portfolio may be invested in Bankers' Acceptances with any one commercial bank. Additionally, the maturity period cannot exceed 180 days.

5. **Commercial Paper**
   Commercial paper is a short-term, unsecured promissory note issued by financial and non-financial companies to raise short-term cash. As provided in Government Code Section 53601(h) up to 25% of the City's portfolio may be invested in "prime" commercial paper of the highest ranking or of the highest letter and number rating as provided by a nationally recognized statistical-rating organization (i.e., Moody's or Standard and Poor's or Fitch), with maturities not to exceed 270 days. The issuer must have total assets in excess of $500 million, and have debt other than Commercial Paper rated "A" or higher by a nationally recognized statistical-rating organization.

6. **Negotiable Certificates of Deposit**
   Negotiable certificates of deposit are a fixed deposit certificate that may be negotiated (traded) to a third party. The institution issuing the certificate promises to pay the holder the initial investment plus the interest rate stated on the certificate at maturity. As authorized in Government Code Section 53601(i), the City may invest 30% of its portfolio in negotiable certificates of deposit issued by commercial banks, thrifts and foreign banks.

7. **Repurchase Agreements**
   Repurchase agreements are agreements between the local agency and seller for the local agency to purchase government securities to be resold back to the seller at a specific date and for a specific amount and are authorized by Government Code Section 53601(j). Although the legal maximum maturity on these investments is 360 days, repurchase agreements are generally short-term investments varying from one day to two weeks. Investments in repurchase agreements must be collateralized, and collateral required for repurchase agreements is limited to Treasury and Agency securities. In order to anticipate market changes and provide a level of security for all funds, the required collateralization level is 102% of market value of principal and accrued interest.

8. **Reverse Repurchase Agreements**
   Reverse repurchase agreements are a sale of securities by the local agency with a simultaneous agreement for the local agency to repurchase the securities on or before a specified date. As provided in Government Code section 53635(j), reverse repurchase agreements require the prior approval of the City Council. Reverse repurchase agreements can only be made with primary dealers of the Federal Reserve Bank of New York or with a nationally or state-chartered bank that has or has had a significant banking relationship with the local agency. There are no portfolio limitations on the amount for these investments.

9. **Medium-Term Corporate Notes**
   As authorized in Government Code Section 53601(k), local agencies may invest in corporate bonds and notes of industrial companies, banks, bank holding companies, insurance companies, thrifts and finance companies that are rated "A" or better by a nationally recognized rating service; and issued by corporations organized and operating in the United States. There are no portfolio limitations for these investments.

10. **Shares of Beneficial Interest Issued By Diversified Management Companies**
    As authorized in Government Code Section 53601(l), local agencies are also authorized to invest in shares of beneficial interest issued by diversified management companies (i.e., mutual funds) as defined in Section 23701(m) of the Revenue and Taxation Code in an amount not to exceed 20% of the agency's portfolio.

11. **Financial Futures and Financial Option Contracts**
    As authorized in Government Code Section 53601.1, local agencies may invest in financial futures or option contracts in any of the above investment categories subject to the same overall portfolio limitations.

12. **Time Certificates of Deposit**
As authorized in Government Code Section 53635, time certificates of deposit are fixed term, non-negotiable investments which are required to be collateralized 110% by eligible pooled securities. The pool is administered by the State, and is composed of a wide variety of government securities, secured by first mortgages on improved residential property located in the State. There are no portfolio limits on the amount; however the maturity period for this investment vehicle may not exceed five years unless approved by the Council.

13. **Local Agency Investment Fund**
As authorized in Government Code Section 16429.1, local agencies may invest in the Local Agency Investment Fund (LAIF), a pooled investment fund managed by the State Treasurer's Office. It operates like a money market fund, but is for the exclusive benefit of governmental entities within the State. The current maximum amount of money that may be invested is $40 million.

14. **Moneys Held By A Trustee Or Fiscal Agent**
As authorized in Government Code Section 53601(m), debt proceeds held by a trustee or fiscal agent, which are pledged to the payment or security of bonds or other indebtedness may be invested in accordance with the statutory provisions governing the issuance of those bonds or other agreement; or to the extent not inconsistent with statutory provisions, or if there are no specific statutory provisions, investments may be made in accordance with the ordinance, resolution, indenture, or agreement of the local agency for the issuance.

This category includes investment agreements approved in writing by insurance companies, supported by appropriate opinions of counsel with notice to Standard and Poor's.

15. **Other Secured Notes, Bonds Or Other Obligations**
As authorized in Government Code Section 53601(n), notes, bonds, or other obligations that are at all times secured by a valid first priority security interest in securities of the types listed by Section 53651 as eligible securities.

16. **Mortgage Pass Through, Collateralized Mortgage Obligation, Mortgage-backed Bond, Equipment Lease-backed Certificate, Consumer Receivable Pass through Certificate, and Consumer Receivable-backed Bond**
As authorized in Government Code Section 53601(o), securities in this category must be rated "AA" or its equivalent or better by a nationally recognized rating service. Purchases may not exceed 20% of the agency's portfolio.

In addition to the authorized investments above, the following investments may be made by Retiree Medical plan funds:

- Up to 100% of the retiree medical plans funds may be invested in equity mutual funds[1] or equity index funds[2], preferred stock[3] and bond funds [4].

[1]Equity Mutual Fund – A financial intermediary that allows a group of investors to pool their money together with a predetermined investment objective. The mutual fund will have a fund manager who is responsible for investing the pooled money into specific securities. When you invest in a mutual fund, you are buying shares of the mutual fund and become a shareholder of the fund. They are very cost effective, as the fund can purchase securities with much lower trading costs then an individual investor. But the biggest advantage to mutual funds is diversification.

[2]Equity Index Fund – A mutual fund that attempts to copy the performance of a stock market index. The most common index fund tries to track the S&P 500 by purchasing all 500 stocks using the same percentages as the index. Index funds have lower fees because computers do most of the work. There is no need to hire an expensive fund manager or research analysts. Index funds can have an expensive ratio as low as .18%, while actively managed funds can have an expense ratio over 3%. Over the long-term, the S&P 500 beats the returns of 80% of actively managed funds.

[3]Preferred Stock – A hybrid between common stock and a bond. Each share of preferred stock is normally paid a guaranteed dividend that receives first priority (i.e., the common stockholders cannot receive a dividend until the preferred dividend has been paid in full) and has priority over the common stockholders relative to the company's assets in the event of bankruptcy.

[4]Bond Fund- A bond fund is a more efficient way of investing in bonds than buying individual securities. Bond mutual funds are just like stock mutual funds in that you put your money into a pool with other investors, and a professional invests that pool of money according to what he or she thinks the best opportunities are. They are very cost effective, as the fund can purchase securities with much lower trading costs then an individual investor. But the biggest advantage to mutual funds is diversification.

Some of the investment vehicles that are Unallowable Investment Vehicles and Restrictions**:**

The Director of Finance/City Treasurer is not authorized to invest in any of the following investment vehicles:

Financial futures; option contracts, floaters, inverse floaters, range notes, interest-only strips that are derived from a pool of mortgages, or any security that could result in zero interest income if held to maturity may not be purchased. Exclusion of these vehicles is consistent with the City's overall objective of achieving reasonable yields on public funds while minimizing risk and capital losses. Although the potential exists for greater interest yields with these vehicles, it is believed that the potential level of risk exceeds their benefits except in very limited circumstances.

See Appendix A for the Investment Portfolio/Diversification Requirements, which lists the maximum amounts that may be invested in the various investment types and the maximum authorized maturities.

In accordance with Government Code Sections 53620-53622, the assets of the City of Berkeley Retiree Medical Plan Trust may be invested in any form or type of investment deemed prudent by the City Council.The maximum maturity for Retiree Medical Plan Trust funds is 30 years.

VI. CASH MANAGEMENT

To achieve a reasonable return on public funds, the following cash management practices will be followed:

- Maintain maximum investment of all City funds not required to meet immediate cash flow needs.
- Maximize the City's cash flow through the immediate deposit of all cash receipts, use of direct deposits and wire transfers when available, and appropriate timing of payments to vendors.
- Maximize the cash flow information available through the use of only one operating bank account.

VII. EVALUATION OF INVESTMENT PERFORMANCE

An actuarial study commissioned by the City many years ago determined that, in addition to City Contributions, an average rate of return of 7% on miscellaneous employees' retiree medical trust fund assets invested must be achieved to fund the retiree health benefit at the desired 70% level. Primarily as a result of the Federal Reserve Board's decision to keep short-term rates near zero for the last 10 years, the average rate currently earned is significantly below that 7% level.

VIII. INVESTMENT REPORTING

Consistent with Sections 16481.2 and 53646 of the Government Code, the Department of Finance shall submit an annual Statement of Investment Policies to the Council for consideration at a public meeting.

In addition to the submittal of an annual Statement of Investment Policies, the Department of Finance shall provide the Council with a quarterly and annual investment report providing the following information for each investment or security:

- Issuer or broker/dealer (financial institution)
- Type of investment
- Certificate or other reference number if applicable
- Percentage yield on an annualized basis
- Purchase date
- Maturity date for each investment and the weighted average maturity of all the investments within the portfolio
- Current book value
- Current market value
- Total cost and market value, including source of this valuation, of the City's portfolio
- A description of the compliance with the Statement of Investment Policies

- An evaluation of investment operations for the preceding year. This shall include an evaluation of how well the objectives have been achieved: the accuracy of forecasting expenditures and revenues, as well as a comparison of the average returns on the investment portfolio with that of the Local Agency Investment Fund (LAIF).
- Report of investments. The Director of Finance shall prepare a report that provides a clear status of the current investment portfolio and transactions. The report will be prepared in a manner which allows the City Manager and Council to ascertain whether investment activities during the reporting period have conformed to the investment policies.

- Summary of key or unusual events, including but not limited to:
  - Any exceptions to policies;
  - Adherence to or deviations from social investment goals;
  - Purchases of Treasury securities, other than in repurchase agreements with maturities of seven days or less;
  - Purchases of securities that exceed maturity limits;
  - Sales of securities more than three months before maturity;
  - Changes in investment procedures, dealers, staff, etc.
- Investment performance;
  - A glossary, defining all funds or accounts referred to elsewhere in the report; and
  - A listing of banks, securities dealers and custodians that the City has had investment transactions during the period.
  - A summary of the certifications for deposits of City funds.
  - Other information regarding the City's portfolio as appropriate

The Quarterly Investment Report shall include all investments as of the end of the quarter from all funds held in the City's portfolio, including funds held and invested by trustees; and shall be issued within 30 days after the end of the quarterly reporting period to the City Manager, and the City Council; the annual report shall be issued within 90 days after the end of the fiscal year to the City Manager, and the City Council.

APPENDIX A

INVESTMENT PORTFOLIO
Diversification Requirements

Investment Instrument	*Maximum Amount Of Portfolio*	*Maximum Length To Maturity*
Bank / Time Deposit Accounts	100%	5 Years
Money Market Deposit Accounts	100%	N/A
Repurchase Agreements	10%	1 Year
Reverse Repurchase Agreements	10%	7 Days
Bankers Acceptances	40%	7 Days
U.S. Government Securities (Treasury Bills, Notes, and Bonds)	100%	30 Years
U.S. Government Agency Securities by Agency	100%	30 Years
Certificates of Deposit (Negotiable)	30%	30 Years
Municipal Bonds	100%	30 Years
Commercial Paper	25%	180 Days
Medium Term Notes	30%	30 years

In addition to the investments above, the following investments may be made by Retiree Medical plan funds:

- Up to 25% of the retiree medical plans funds may be invested in equity mutual funds[1] or

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equity index funds[2], and preferred stock[3].

[1]Equity Mutual Fund – A financial intermediary that allows a group of investors to pool their money together with a predetermined investment objective. The mutual fund will have a fund manager who is responsible for investing the pooled money into specific securities. When you invest in a mutual fund, you are buying shares of the mutual fund and become a shareholder of the fund. They are very cost effective, as the fund can purchase securities with much lower trading costs then an individual investor. But the biggest advantage to mutual funds is diversification.

[2]Equity Index Fund – A mutual fund that attempts to copy the performance of a stock market index. The most common index fund tries to track the S&P 500 by purchasing all 500 stocks using the same percentages as the index. Index funds have lower fees because computers do most of the work. There is no need to hire an expensive fund manager or research analysts. Index funds can have an expensive ratio as low as .18%, while actively managed funds can have an expense ratio over 3%. Over the long-term, the S&P 500 beats the returns of 80% of actively managed funds.

[3]Preferred Stock – A hybrid between common stock and a bond. Each share of preferred stock is normally paid a guaranteed dividend that receives first priority (i.e., the common stockholders cannot receive a dividend until the preferred dividend has been paid in full) and has priority over the common stockholders relative to the company's assets in the event of bankruptcy.