



CITY of NOVI CITY COUNCIL

Agenda Item O
December 19, 2011

SUBJECT: Approval to amend the Statement of Investment Policy, Objectives and Guidelines, City of Novi Retiree Health Care Fund to provide additional clarification, update the actuarial information (section D), and update the styles index (benchmark) example (section H).

SUBMITTING DEPARTMENT: Finance/Treasury

CITY MANAGER APPROVAL:

BACKGROUND INFORMATION:

The City of Novi administers its own Retiree Health Care Fund, rather than through a third party administrator. Policies and procedures based on best practice and Public Acts 20, 149 and 314, have been implemented by the City. Best practice recommends an investment policy for the retiree health care fund investments.

The Finance/Treasury staff periodically review policies and procedures to ensure the information is accurate and up-to-date. While reviewing the attached policy we noted a couple of the indices in the Styles Index (benchmark example) were no longer valid. We reviewed the City's policy in comparison with other communities for best practices and also shared it with our investment consultants. The culmination of recommendations is included in this amended policy, which provides additional clarification and understanding of the City's intent. The amended policy includes the following changes:

- Update language throughout the document to refer to Public Act 314
- Update Actuarial Information, Section D
- Add "Investment Consultant Responsibilities" description to Section E
- Update the Styles Index (benchmark) example to reflect current indices

Enclosed are the red-line and clean versions reflecting the recommended changes.

The Finance/Treasury staff request the approval to update and amend the City's Retiree Health Care Investment Fund Policy.

RECOMMENDED ACTION: Approval to amend the Statement of Investment Policy, Objectives and Guidelines, City of Novi Retiree Health Care Fund to provide additional clarification, update the actuarial information (section D), and update the styles index (benchmark) example (section H).

	1	2	Y	N
Mayor Gatt				
Mayor Pro Tem Staudt				
Council Member Casey				
Council Member Fischer				

	1	2	Y	N
Council Member Margolis				
Council Member Mutch				
Council Member Wrobel				

**STATEMENT OF INVESTMENT POLICY,
OBJECTIVES & GUIDELINES**

Of the

**CITY OF NOVI
RETIREMENT HEALTH CARE FUND**

Statement of Investment Policy, Objectives, and Guidelines City of Novi, Retiree Health Care Fund

A. GENERAL INFORMATION

The City of Novi Retiree Health Care Fund was established to provide for the retirement health care benefits for covered retirees and their beneficiaries. The Fund is financed by contributions from the City and investment earnings. Distributions from the Fund are to pay for the medical insurance premiums and for investment and administrative expenses.

The Plan is created under the authority of the Public Employee Health Care fund Investment Act, Public Act 149 of 1999, as amended to invest the assets of the Plan in accordance with the provisions of Public Act 314 of 1965, as amended.

Federal Tax ID# 38-6032551
Fund Fiscal Year End June 30th
Primary Contacts Kathy Smith-Roy, Finance Director/Treasurer
Beverly Valente, Assistant Treasurer

B. SCOPE OF THIS INVESTMENT POLICY

This statement reflects the investment policy, objectives and guidelines (“Investment Policies”), which the City of Novi (City Council and Administration) currently considers appropriate for the City of Novi Retiree Health Care Fund.

C. PURPOSE OF THIS INVESTMENT POLICY STATEMENT

This statement of Investment Policies is set in order to:

- Establish a long-term strategic investment plan for the Fund. Including, but not limited to, evaluating the City’s risk tolerance and determining a long-term asset allocation policy consistent with the long-term investment objectives, financial needs and circumstances of the Fund and the City.
- Define and assign the responsibilities of all involved parties.
- Establish a clear understanding for all involved parties of the investment goals and objectives of the City of Novi Retiree Health Care Fund assets.
- Offer guidance and limitations to all Investment Managers regarding the investment of City of Novi Retiree Health Care Fund assets.
- To monitor and evaluate the performance of the Fund’s assets as a whole and each investment manager.

- Manage City of Novi Retiree Health Care Fund assets according to prudent standards as described herein under the "General Investment Policy."

This document will identify and present a set of Investment Policies which will serve to provide guidance to any Investment Management Consultant(s) and/or Investment Manager(s). The policy is intended to be sufficiently specific to be meaningful, yet flexible enough to be practical. This document is intended to supplement the *City of Novi Investment Policy*, and provide additional guidance for the management of the investments of the City of Novi Retiree Health Care Fund.

D. ACTUARIAL INFORMATION

The following information has been provided by Gabriel, Roeder, Smith and Company, and is published in the July 1, ~~2007-2011~~ Actuarial Report:

Actuarial valuation of assets:	\$7,992,415 <u>14,924,821</u>
Actuarial valuation of liabilities:	\$18,829,286 <u>24,313,035</u>
Funded ratio:	42.461.4%
Actuarial discount rate:	8%
Number of active employees:	245 <u>200</u>
Number of retired participants:	4352 <u>(out of 63 eligible)</u>

E. RESPONSIBILITIES OF INVESTMENT MANAGERS

The City intends to utilize separately managed accounts with various investment management firms, however mutual or other commingled funds may be used from time to time to implement the investment strategy of the Fund, where practical. For mutual and other commingled funds, the prospectus or Declaration of Trust documents of the fund(s) will govern the investment policies of fund investments.

Fiduciary Responsibilities

Each investment manager is expected to manage the Fund's assets in a manner consistent with the investment objectives, guidelines and constraints outlined in this statement and in accordance with applicable laws. This would include discharging responsibilities with respect to the Fund consistent with "Prudent Investor" standards, and all other fiduciary responsibility provisions and regulations. The Fund's assets will be managed by experienced investment management firms.

Each investment manager shall:

- Obtain and maintain bonds and other surety agreements sufficient in amount to comply with all applicable laws and to protect the interests of the City. The investment manager

shall provide proof of such insurance and amounts of coverage to the City's Treasurer's Department on an annual basis;

- At all times be registered as an investment advisor under the Investment Advisers Act of 1940 (where applicable); and
- Acknowledge in writing that they are a fiduciary with respect to the assets they manage.

Investment Consultant Responsibilities

The primary role of the investment consultant(s) is to provide objective, third party advice and counsel that will enable the fund fiduciaries to make well-informed and well-educated decisions regarding the investment of Plan assets

The investment consultant's role is that of an advisor to the Retiree Health Care Fund. The investment consultant acknowledges its responsibilities as a co-fiduciary under Act 314 of 1965, as amended. The investment consultant acknowledges that it is a registered investment advisor under with the Investment Advisers Act of 1940 or the Michigan Uniform Securities Act.

Investment advice offered by the Investment Consultants will be consistent with the investment objectives, policies, guidelines and constraints as established in this statement.

Security Selection/Asset Allocation

- Except as noted below, each investment manager shall have the discretion to determine their portfolio's individual security selections;
- Each investment manager has been delegated responsibility for establishing and maintaining the asset allocation strategy for their individual portfolio. It is expected however, that each investment manager will utilize a stable asset allocation strategy and not engage in market-timing asset allocation decisions. The performance of each investment manager is measured versus a fully invested market index, or combination of market indexes, representative of the investment manager's investment style, asset allocation and risk level;
- The asset allocation strategy for each investment manager's portfolio can deviate from the overall Fund's asset allocation, however, the City's Treasury Department is responsible for monitoring the aggregate asset allocation, and may re-balance to the target allocation on a periodic basis.

Proxy Voting

Each investment manager is responsible and empowered to exercise all rights, including voting rights, as are required through the purchase of securities, where practical. Each investment manager shall vote proxies according to their established Proxy Voting Guidelines. A copy of those guidelines, and/or a summary of proxy votes shall be provided to the City upon

request. The City's Treasury Department is responsible for voting any proxies received from Investment Companies retained in the Fund and for any other "Self-Directed" investments.

F. INVESTMENT MANAGEMENT OBJECTIVES

The priority listing of investment objectives is as follows:

1. Preservation of Capital - Consistent with their respective investment styles and philosophies, investment managers should make reasonable efforts to preserve capital, understanding that losses may occur in individual securities.
2. Risk Aversion - Understanding that risk is present in all types of securities and investment styles, the City recognizes that some risk is necessary to produce long-term investment results that are sufficient to meet the City of Novi Retiree Health Care Fund's objectives. However, the investment managers are to make reasonable efforts to control risk, and will be evaluated regularly to ensure that the risk assumed is commensurate with the given investment style and objectives.
3. Diversification of Assets – Investments of the City of Novi Retiree Health Care Fund shall be so diversified as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so.
4. Liquidity of Assets – Cash is to be employed productively at all times, by investment of short term cash equivalents to provide safety, liquidity, return, and restructuring of the City of Novi Retiree Health Care Fund portfolio to meet the City of Novi Retiree Health Care Fund's changing needs over time.
5. Adherence to Investment Discipline - Investment managers are expected to adhere to the investment management styles for which they were hired. Investment managers will be evaluated regularly for adherence to investment discipline.

G. INVESTMENT RETURN OBJECTIVES

In order to meet its obligations, the investment objective of the City of Novi Retiree Health Care Fund is to emphasize total return; that is, the aggregate return from capital appreciation and dividend and interest income.

The *primary* investment return objective shall be:

Long-Term Growth of Capital – To emphasize long-term growth of principal while avoiding excessive risk. Short-term volatility will be tolerated inasmuch as it is consistent with the volatility of a comparable market index.

The *secondary* investment return objective shall be:

Income and Growth - To achieve a balanced return of current income and modest growth of principal.

H. Performance Objectives

The City's Treasurers Department will monitor the performance of the fund. The City's Treasurers Department will evaluate each investment manager's contribution toward meeting the investment objectives outlined below over a three-to-five-year time period and a full market cycle, unless otherwise noted.

Style Index: Over a given market cycle, (typically defined as 3 to 5 years), the time weighted total rate of investment return should exceed, for the total fund, an appropriately designed custom benchmark. The custom benchmark is based on the fund's and investment manager's investment style, actual asset allocations, and constructed with appropriate indices given the asset mix. For example: (i.e. 20% Russell 1000 Growth Index, 20% Russell 1000 Value Index, 5% Russell 2000 Growth Index, 10% MSCI EAFE, 5% Russell 2000 Value Index, 3% S&P 500 Index, 3% S&P 400 index, 40% LB Agg Bond Index, 2% REIT Index, 1% PVI Index, 30% Barclays Capital Aggregate Bond Fund (using appropriate sub-category based on credit quality, duration, etc.), 10% 90 Day T-Bill.)

Secondary Performance Targets:

1. The real return goal (return after adjusting for inflation) for the Fund assets is **3.0%**. Inflation shall be measured by the U.S. All Urban Consumers Price Index ("CPI"); and
2. The Fund is expected to outpace the style index return measured on a compound average annual return basis after the deduction of investment management fees and annualized over a three-to-five-year rolling time period and a full market cycle.

I. Risk Tolerance

Investment theory and historical capital market return data suggests that, over long periods of time, there is a relationship between the level of risk assumed and the level of return that can be expected in an investment program. In general, higher risk (i.e. volatility of return) is associated with higher return.

Given this relationship between risk and return, a fundamental step in determining the investment policy for the Fund is the determination of an appropriate risk tolerance. The Investment Committee examined two important factors that affect the City's risk tolerance:

Financial Ability to accept risk within the investment program and,

Willingness to accept return volatility.

Positive factors that contribute to a higher risk tolerance are:

- The financial strength of the City provides the ability to withstand some uncertainty in changes in funding cost of the Fund;
- Contributions to the Fund are determined during the budget process based on recommended actuary percentages of payroll, and other financial considerations, and thus are generally known in advance and stable from year-to-year;
- The City's willingness to accept short-term volatility in the market value of the Fund and in the funding ratio for the sake of earning higher long-term returns; and
- The long-term time horizon available for investment provides the opportunity to benefit from the opportunities for growth that may accrue to a patient investment strategy.

Offsetting these factors are:

- The cash flow requirements of the Fund are on-going, thus requiring the Fund to maintain sufficient liquidity to finance required distributions;
- The medical cost inflation rate has historically been significantly higher and more volatile than the overall inflation rate of the US economy. This implies greater uncertainty in future costs of this Fund; and
- Cyclical economic activity can significantly influence the finances of the City and its financial ability to fund large unexpected contributions.

J. INVESTMENT GUIDELINES

All investment guidelines and restriction of Federal and Michigan law as well as Retiree Health Care fund investment policy must be complied with, including and specifically Public Act 314.

1. Permitted Securities

(a). Cash Equivalents

- ◆ Treasury Bills
- ◆ Money Market Funds
- ◆ STIF Funds
- ◆ Commercial Paper
- ◆ Banker's Acceptances
- ◆ Repurchase Agreements
- ◆ Certificates of Deposit

(b). Fixed Income Securities – must have a readily ascertainable market value and must be readily marketable.

- ◆ U.S. Government and Agency Securities
- ◆ Corporate Notes and Bonds
- ◆ Mortgage Backed Bonds
- ◆ Fixed Income Securities of Foreign Governments and Corporations
- ◆ Convertible Notes and Bonds

(c). Equity Securities – all equity investments will be made within the guidelines of the prudent trustee rule and within the requirements of Public Act 314. Investments in American Depository Receipts (ADR's) will be designated as foreign securities for asset allocation purposes under the act.

- ◆ Common Stocks
- ◆ American Depository Receipts (ADRs) of Non-U.S. Companies
- ◆ Stocks of Non-U.S. Companies (Ordinary Shares)
- ◆ Preferred Stock
- ◆ Convertible Preferred Stocks

(d). Other Assets

- ◆ Mutual Funds, which invest in securities as allowed in this document.
- ◆ Real Estate Securities (i.e. equity REITs, mortgage REITs, CMO or mortgage-related securities REITs, Health Care REITs, and equities of real estate operating companies)
- ◆ International Securities

2. Asset Allocation Guidelines

In line with the return objectives and risk parameters of the Fund, the mix of assets should be generally maintained as follows (percentages are of the market value of the Fund):

	<u>Minimum</u>	<u>Maximum</u>	<u>Target</u>
Domestic Large/Medium Cap Equities: 30% to 55%			
Domestic Large Cap Equities (growth & value)	30%	55%	40-50%
Domestic Small/Medium Cap Equities: 5% to 30%			
Domestic Small/Mid Cap Equities (growth & value)	5%	20%	10-15%
International Equity	5%	15%	5-10%
Total Equity	50%	70%	60%
Real Estate	0%	5%	2-5%
Investment Grade Fixed Income	20%	30%	25-30%
Cash/Cash Equivalents	5%	15%	10%

~~After giving consideration to the City of Novi Retiree Health Care Fund's potential short-term liquidity requirements, the City of Novi Retiree Health Care Fund shall maintain no more than a maximum of 10% of total assets in cash or cash equivalents.~~

3. Diversification Requirements

To minimize the risk of large losses, each investment manager shall maintain adequate diversification in their portfolio. Subject to the constraints outlined in this policy, each investment manager shall have the discretion to determine their portfolio's individual security selections.

In order to achieve a prudent level of portfolio diversification, the securities of any one company should not exceed 5% of the total fund, and no more than 20% of the total fund should be invested in any one industry. The total allocation to treasury bonds and notes may represent up to 100% of the City of Novi Retiree Health Care Fund's aggregate bond position and treasury securities may represent up to 60% of the total fund.

4. Prohibited Transactions

Prohibited transactions include those identified under Public Act 314 including at Michigan Compiled Laws 38.1133(5) and those specifically identified below:

Short Selling
Margin Transactions
Agency Cross Trades

K. PROCEDURAL GUIDELINES

1. The Investment Manager will:

- a) Provide monthly portfolio appraisals including the market value and cost of all assets as well as the estimated annual level of interest and dividend income.
- b) Meet periodically, at not less than once each year with the City of Novi staff to review the portfolio under supervision, discuss the investment outlook for the economy and securities markets, and indicate anticipated portfolio changes.
- c) Provide written information of security transactions.

2. The City of Novi will notify the Investment Manager of:

- a) Any changes in the Investment Policies and procedures noted above.
- b) Provide information regarding significant anticipated changes in cash flow and/or cash flow needs.

L. INVESTMENT MANAGER PERFORMANCE REVIEW AND EVALUATION

The investment performance of total portfolios, as well as asset class components, will be measured against commonly accepted performance benchmarks. Consideration shall be given to the extent to which the investment results are consistent with the Investment Policies. The City intends to evaluate the portfolio(s) over at least a three-year period, but reserves the right to terminate an Investment Manager for any reason including, without limitation, the following:

1. Investment performance, which is significantly less than anticipated given the discipline employed, and the risk parameters established, or unacceptable justification of poor results.
2. Failure to adhere to any aspect of these Investment Policies, including communication and reporting requirements as well as their investment management agreement.
3. Significant qualitative or quantitative changes to the Investment Manager's organization.

Investment managers shall be reviewed regularly regarding performance, personnel, strategy, research capabilities, organizational and business matters, and other qualitative or quantitative factors that may impact their ability to achieve the desired investment results in conformance with these Investment Policies.



Approved by the Novi City Council on: _____ December ~~17, 2007~~ 19, 2011

Clean Copy of
Statement of Investment
Policy, Objectives &
Guidelines of the City of
Novi Retirement Health
Care Fund

**STATEMENT OF INVESTMENT POLICY,
OBJECTIVES & GUIDELINES**

Of the

**CITY OF NOVI
RETIREMENT HEALTH CARE FUND**

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Federal Tax ID#	38-6032551
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Primary Contacts	Kathy Smith-Roy, Finance Director/Treasurer Beverly Valente, Assistant Treasurer

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3. Diversification of Assets – Investments of the City of Novi Retiree Health Care Fund shall be so diversified as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so.
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Secondary Performance Targets:

1. The real return goal (return after adjusting for inflation) for the Fund assets is **3.0%**. Inflation shall be measured by the U.S. All Urban Consumers Price Index ("CPI"); and
2. The Fund is expected to outpace the style index return measured on a compound average annual return basis after the deduction of investment management fees and annualized over a three-to-five-year rolling time period and a full market cycle.

I. Risk Tolerance

Investment theory and historical capital market return data suggests that, over long periods of time, there is a relationship between the level of risk assumed and the level of return that can be expected in an investment program. In general, higher risk (i.e. volatility of return) is associated with higher return.

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Financial Ability to accept risk within the investment program and,

Willingness to accept return volatility.

Positive factors that contribute to a higher risk tolerance are:

- The financial strength of the City provides the ability to withstand some uncertainty in changes in funding cost of the Fund;

- Contributions to the Fund are determined during the budget process based on recommended actuary percentages of payroll, and other financial considerations, and thus are generally known in advance and stable from year-to-year;
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- The long-term time horizon available for investment provides the opportunity to benefit from the opportunities for growth that may accrue to a patient investment strategy.

Offsetting these factors are:

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- The medical cost inflation rate has historically been significantly higher and more volatile than the overall inflation rate of the US economy. This implies greater uncertainty in future costs of this Fund; and
- Cyclical economic activity can significantly influence the finances of the City and its financial ability to fund large unexpected contributions.

J. INVESTMENT GUIDELINES

All investment guidelines and restriction of Federal and Michigan law as well as Retiree Health Care fund investment policy must be complied with, including and specifically Public Act 314.

1. Permitted Securities

(a). Cash Equivalents

- ◆ Treasury Bills
- ◆ Money Market Funds
- ◆ STIF Funds
- ◆ Commercial Paper
- ◆ Banker's Acceptances
- ◆ Repurchase Agreements
- ◆ Certificates of Deposit

(b). Fixed Income Securities – must have a readily ascertainable market value and must be readily marketable.

- ◆ U.S. Government and Agency Securities
- ◆ Corporate Notes and Bonds
- ◆ Mortgage Backed Bonds
- ◆ Fixed Income Securities of Foreign Governments and Corporations
- ◆ Convertible Notes and Bonds

(c). Equity Securities – all equity investments will be made within the guidelines of the prudent trustee rule and within the requirements of Public Act 314. Investments in American Depository Receipts (ADR's) will be designated as foreign securities for asset allocation purposes under the act.

- ◆ Common Stocks
- ◆ American Depository Receipts (ADRs) of Non-U.S. Companies
- ◆ Stocks of Non-U.S. Companies (Ordinary Shares)
- ◆ Preferred Stock
- ◆ Convertible Preferred Stocks

(d). Other Assets

- ◆ Mutual Funds, which invest in securities as allowed in this document.
- ◆ Real Estate Securities (i.e. equity REITs, mortgage REITs, CMO or mortgage-related securities REITs, Health Care REITs, and equities of real estate operating companies)
- ◆ International Securities

2. Asset Allocation Guidelines

In line with the return objectives and risk parameters of the Fund, the mix of assets should be generally maintained as follows (percentages are of the market value of the Fund):

	<u>Minimum</u>	<u>Maximum</u>	<u>Target</u>
Domestic Large/Medium Cap Equities: 30% to 55%			
Domestic Large Cap Equities (growth & value)	30%	55%	40-50%
Domestic Small/Medium Cap Equities: 5% to 30%			
Domestic Small/Mid Cap Equities (growth & value)	5%	20%	10-15%
International Equity	5%	15%	5-10%
Total Equity	50%	70%	60%
Real Estate	0%	5%	2-5%
Investment Grade Fixed Income	20%	30%	25-30%
Cash/Cash Equivalents	5%	15%	10%

3. Diversification Requirements

To minimize the risk of large losses, each investment manager shall maintain adequate diversification in their portfolio. Subject to the constraints outlined in this policy, each investment manager shall have the discretion to determine their portfolio's individual security selections.

In order to achieve a prudent level of portfolio diversification, the securities of any one company should not exceed 5% of the total fund, and no more than 20% of the total fund should be invested in any one industry. The total allocation to treasury bonds and notes may represent up to 100% of the City of Novi Retiree Health Care Fund's aggregate bond position and treasury securities may represent up to 60% of the total fund.

4. Prohibited Transactions

Prohibited transactions include those identified under Public Act 314 including Michigan Compiled Laws 38.1133(5) and those specifically identified below:

Short Selling
Margin Transactions
Agency Cross Trades

K. PROCEDURAL GUIDELINES

1. The Investment Manager will:

- a) Provide monthly portfolio appraisals including the market value and cost of all assets as well as the estimated annual level of interest and dividend income.
- b) Meet periodically, at not less than once each year with the City of Novi staff to review the portfolio under supervision, discuss the investment outlook for the economy and securities markets, and indicate anticipated portfolio changes.
- c) Provide written information of security transactions.

2. The City of Novi will notify the Investment Manager of:

- a) Any changes in the Investment Policies and procedures noted above.
- b) Provide information regarding significant anticipated changes in cash flow and/or cash flow needs.

L. INVESTMENT MANAGER PERFORMANCE REVIEW AND EVALUATION

The investment performance of total portfolios, as well as asset class components, will be measured against commonly accepted performance benchmarks. Consideration shall be given to the extent to which the investment results are consistent with the Investment Policies. The City intends to evaluate the portfolio(s) over at least a three-year period, but reserves the right to terminate an Investment Manager for any reason including, without limitation, the following:

1. Investment performance, which is significantly less than anticipated given the discipline employed, and the risk parameters established, or unacceptable justification of poor results.
2. Failure to adhere to any aspect of these Investment Policies, including communication and reporting requirements as well as their investment management agreement.

3. Significant qualitative or quantitative changes to the Investment Manager's organization.

Investment managers shall be reviewed regularly regarding performance, personnel, strategy, research capabilities, organizational and business matters, and other qualitative or quantitative factors that may impact their ability to achieve the desired investment results in conformance with these Investment Policies.

Approved by the Novi City Council on: _____ December 19, 2011 _____