

TOWN OF YARMOUTH
OPEB Liability Trust
Investment Policy Statement

The primary purpose of this Investment Policy Statement (IPS) is to provide a clear understanding between the Town of Yarmouth, (Town) and Rockland Trust Company (Investment Manager) regarding the objectives, goals, risk tolerance, and investment guidelines established for the OPEB (Other Post-Employment Benefits) Liability Trust Fund. The secondary purpose is to describe the underlying logic and philosophy supporting this Statement.

I. The Investment of OPEB Trust funds

A. Scope

This IPS applies to all funds that are separately designated as long-term OPEB funds. The account will be established as a pooled investment portfolio unless otherwise stated. Any additional contributions to the account will be maintained in the same manner.

B. Authority

Massachusetts General Law Chapter 32B, section 20 allows a city, town, district, county or municipal lighting plant to set up a special trust fund, the Other Post Employment Benefits (OPEB) Liability Trust Fund. The governmental unit's treasurer is the custodian of the fund or in the case of a light plant, an officer designated by the board. Investment of fund monies by the custodian must be consistent with the prudent person standard set forth in Massachusetts General Law Chapter 203C for private trust funds. Interest earned on the investment of fund monies belongs to the fund.

C. Introduction

Creating an investment policy is the most critical phase of the entire investment process. The effects of a properly drafted vs. ineffective investment policy statement can be more important than the effects of good or poor investment management. To be successful, an investment policy needs to be appropriate for its setting and intended purpose. The policy needs to match the needs of the anticipated requests or periodic disbursements from the financial assets most likely to meet those cash flow needs.

The best way to minimize investment risk is to match, as closely as possible, the timing of future liabilities with the timing of future cash flows from the portfolio assets. Furthermore, with regards to OPEB liabilities, the policy needs to stipulate those permitted investments most likely able, over the long-term, to approximate the rate of return, or discount rate, targeted by the Town's actuarial study.

Under GASB 45, the discount rate should be the long-term expected yield on the investments to be used to pay benefits as they come due. These would be plan investments for a funded plan or a weighted average of expected plan and employer investments for a plan that is partially funded. Investments within an OPEB Trust will closely approximate pension fund-type investment securities.

The policy statement is also designed to withstand "trustee risk" - the possibility that, at some stress point (most frequently an extreme decline in the stock or bond markets), those who oversee the funds may react in a manner detrimental to the long-term health of the Trust Fund.

D. Objective

OPEB funds are long-term investments. Given a stated discount rate target, this long-term approach enables the town to purchase long-term assets, such as equities, which tend to have high returns over many years but whose

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price volatility precludes their use by those with shorter time horizons. By keeping a long-term focus in mind at all times, we hope to weather the periodic bad times.

We expect this long-term view to provide better results than will be earned by those who pick short-term investments or who liquidate securities during turbulent times. We also expect that equities will serve as a hedge against eroding trust fund values due to long-term inflationary trends.

We expect the stock market to provide greater total returns than the bond market. We make this statement in a long-term sense, knowing that both economies and markets suffer periodic (but normally brief) declines, and knowing that there have been periods when cash and bonds outperform stocks.

We expect the relationship between the economy, the stock market, and inflation to continue. We expect the American economy to show modest real growth over full business cycles after allowance for occasional recessions. We expect stock prices to grow slightly faster than inflation, although the naturally volatile nature of the stock market will make such growth invisible except when observed over longer periods of time. We expect cash dividends from stocks to also grow slightly faster than inflation and to fluctuate much less than stock prices do.

We expect continued inflation. Its timing and severity we cannot predict, but we believe it will be of sufficient magnitude that to ignore it would threaten our ability to meet our long-term objectives.

Our definition of risk is not always the common one. Most investors define investment risk in terms of the volatility of short-term total returns. This definition is appropriate for funds with a very short-term time horizon, but inappropriate for quasi-perpetual funds such as this OPEB Liability Trust Fund. Our managed funds bear three potential kinds of risk. One comes from any mismatch between the natural cash flows out of the Trust (the amount requisitioned from the Trust) and the cash flows coming in (from contributions, dividends and interest). A second source of risk is the possibility that the assets in the funds do not perform the way the investment manager(s) or we expect. The third form of risk is that of reacting inappropriately during a volatile period - most likely after a severe market decline. We hope to minimize these risks to as great a degree as possible without harming the trust fund's long-term objectives. Market value fluctuations are of secondary importance unless individual assets have permanently impaired values and must be liquidated to preserve any remaining value.

E. Strategy

The Investment Manager(s) will utilize the following investment guidelines in terms of asset allocation. This policy is subject to review and amendment at any time.

0 - 10%

Cash and cash equivalents - normalized at 2% over time as the trust fund grows larger. Cash will be maintained to provide periodic cash distributions. Cash will not normally be held as a strategic investment asset, although the Investment Manager may seek to allow cash to build to the maximum level in times of market uncertainty.

0 - 15%

Alternative Investments - normalized at 6%. Alternative Investment strategies include, but are not limited to, investment vehicles with the following objectives: market-neutral, absolute return, global macro, long/short, commodities, managed futures and arbitrage.

35 - 55%

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Fixed Income - normalized at 43%. To ensure appropriate diversification and to minimize default risk, the trust fund will be invested primarily in high-quality taxable bonds, notes, and other credits through mutual funds, exchange-traded funds (ETFs) or individual bonds. Lower-quality bonds may be held through mutual fund or ETF ownership. The overall goal of the fixed-income portion of the portfolio is to provide returns competitive with, and price volatility similar to, the Barclays Aggregate Bond Index. The fixed income allocation exists to provide income and to dampen the volatility from the fund's equity holdings.

40 - 65%

Equities - normalized at 49%. To ensure appropriate diversification, the fund will be invested in high-quality domestic stocks, growth stocks of emerging companies and foreign issues. The equity portion of the portfolio should consist of a diversified mix of investments (individual equities, mutual funds and exchange-traded funds) suitable to achieve the objective of capital appreciation. Individual equity holdings in any one company should not exceed 5% of the market value of the portfolio

Adequate diversification and risk controls must be maintained within each sub-category. An appropriate benchmark for the overall asset class of equities, as well as each sub-strategy, will be determined and agreed upon between the Town and the Investment Manager(s).

F. Investment Instruments

M.G.L. Chapter 203C: Section 1 known as the Massachusetts Prudent Investor Act, states that a trustee shall invest and manage trust assets as a prudent investor would, considering the purposes, terms, and other circumstances of the trust, including those set forth in subsection c. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution. A trustee's investment and management decisions respecting individual assets shall be considered in the context of the trust portfolio as a part of an overall investment strategy reasonably suited to the trust.

Section 3:

Among circumstances that a trustee shall consider in investing and managing trust assets are such of the following as are relevant to the trust or its beneficiaries: 1) general economic conditions; 2) the possible effect of inflation or deflation; 3) the expected tax consequences of investment decisions or strategies; 4) the role that each investment or course of action plays within the overall trust portfolio; 5) the expected total return from income and appreciation of capital; 6) other resources of the beneficiaries; 7) needs for liquidity, regularity of income, and preservation or appreciation of capital; and 8) an asset's special relationship or special value, if any, to the purposes of the trust or to one of the beneficiaries.

A trustee shall make a reasonable effort to verify facts relevant to the investment and management of trust assets. A trustee may invest in any kind of property or type of investment consistent with the standards of this chapter. A trustee, who has special skills or expertise, shall have a duty to use such special skills or expertise.

Section 4:

A trustee shall reasonably diversify the investments of the trust unless, under the circumstances, it is prudent not to do so.

The Treasurer/Custodian may invest in the following instruments:

- U. S. Treasuries that may be sold prior to maturity: **Unlimited amounts** (With no limit to the length of maturity from date of purchase)

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- U.S. Agency obligations that may be sold prior to maturity: **Unlimited amounts** (With no limit to the length of maturity from date of purchase)
- Bank accounts or Certificates of Deposit ("CDs"): **Unlimited amounts** (With no limit to the length of maturity from date of purchase), which is fully collateralized through a third party agreement.
- Bank accounts and CDs: (With no limit to the length of maturity from date of purchase) fully insured by F.D.I.C. and in some cases also Depository Insurance Fund of Massachusetts (D.I.F.): All bank accounts and CDs in one institution are considered in the aggregate to receive the insurance coverage limit.
- Corporate Bonds rated investment grade by Moody's or S&P (with no limit to length of maturity)
- Money market mutual funds.
- Fixed-income mutual funds and exchange-traded funds (ETFs).
- Preferred stock: securities must be investment grade at the time of purchase.
- Common stock
- Equity mutual funds and exchange-traded funds (ETFs).
- Alternative investment-oriented mutual funds. Leveraged (i.e. 2x or 3x) investment strategies are not permitted.

G. Specific Risks

- **Credit Risk**

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations.

The Treasurer/Custodian will manage credit risk several ways. There will be no limit to the amount of United States Treasury and United States Government Agency obligations.

In regards to fixed-income investments, the Treasurer/Custodian will only purchase investment grade securities with a high concentration in securities rated A or better. Lower-quality investments may only be held through diversified vehicles, such as mutual funds or exchange-traded funds. Investments in fixed income securities will be made primarily for income and capital preservation. The Treasurer/Custodian may invest in the Massachusetts Municipal Depository Trust (MMDT) with no limit to the amount of funds placed in the fund.

- **Custodial Risk**

The custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party.

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The Treasurer/Custodian will review the financial institution's financial statements and the background of the sales representative. The intent of this qualification is to limit the Fund's exposure to only those institutions with a proven financial strength, capital adequacy, and overall affirmative reputation in the municipal industry.

Further, all securities not held directly by the Treasurer/Custodian, will be held in the Town's name and tax identification number by a third party custodian approved by the Treasurer/Custodian and evidenced by statements showing individual CUSIP numbers for each security.

- **Concentration of Credit Risk**

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer.

The Treasurer/Custodian will minimize Concentration of Credit Risk by diversifying the investment portfolio so that the impact of potential losses from any one type of security or issuer will be minimized. As stated above, securities of a single corporate issuer (with the exception of the United States Government and its Agencies) will not exceed 5% of the portfolio value.

- **Interest Rate Risk**

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Treasurer/Custodian will manage interest rate risk by managing duration in the account.

H. Standards of Care

The standard of prudence to be used by the Treasurer/Custodian shall be the "Prudent Person" standard and shall be applied in the context of managing an overall portfolio. The Treasurer/Custodian acting in accordance with written procedures and this IPS, and exercising reasonable due diligence, shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided the purchase and sale of securities is carried out in accordance with the terms of this IPS.

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.

In addition, this section would also apply to M.G.L, Chapter 44 Section 55A which refers to the liability of the Treasurer/Custodian for losses due to bankruptcy.

I. Diversification

Equity

The equity portion of the portfolio should consist of a diversified mix of investments (individual equities, mutual funds and exchange-traded funds) suitable to achieve the objective of capital appreciation. Individual equity holdings in any one company should not exceed 5% of the market value of the portfolio.

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Equity holdings may be selected from the New York and American Stock Exchange or the NASDAQ markets. Securities may be in U.S. companies or foreign companies purchased as American Depository Receipts (ADR's). Funds may be invested in securities convertible into equities or preferred stock.

No funds may be invested in real estate, private placements or letter stock. The Investment Manager shall not engage in margin transactions, short sales or any other such specialized investment vehicles. The manager of a specific mutual fund and exchange-traded fund, however, may engage in short sales as part of an overall investment strategy.

The selection of individual equities will be at the discretion of the Investment Manager.

Fixed Income

Investments in fixed income securities will be made principally for income and capital preservation. Selection should be made from liquid, investment grade corporate debt, convertible debt and obligations of the United States Government and its agencies. Lower-quality investments may only be held through diversified vehicles such as mutual funds or exchange-traded funds.

Securities of a single corporate issuer (excluding the United States Government and its Agencies) will not exceed 5% of the portfolio market value. Investments in U.S. Government debt will not include agencies that are not permitted under Massachusetts General Laws (i.e. Sallie Mae (SLMA) or Ginnie Mae (GNMA) obligations).

No more than 20% of the portfolio's total market value will be invested in convertible securities.

Individual corporate debt and preferred stock issues must be rated BBB or better, as defined by Moody's and/or Standard & Poor's Rating Agency.

There shall be no investments in real estate, private placements, fixed income or interest rate futures, and no engagement in any other specialized fixed income ventures. The manager of a specific mutual fund and exchange-traded fund, however, may engage in fixed income and interest rate futures as part of an overall investment strategy.

Diversification should be interpreted in two ways: in terms of maturity as well as instrument type and issuer. The diversification concept should include prohibition against over concentration of maturities, as well as concentration in a specific institution with the exception of U.S. Treasury obligations or investments fully collateralized by U.S. Treasuries or agencies.

The selection of individual fixed income securities shall be at the discretion of the Investment Manager.

J. Ethics

The Treasurer/Custodian shall refrain from any personal activity that may conflict with the proper execution of the investment program or which could impair or appear to impair ability to make impartial investment decisions. The Treasurer/Custodian shall disclose to the Town Manager/Council any material financial interest in financial institutions that do business with the town. They shall also disclose any large personal financial investment positions or loans that could be related to the performance of the trust funds.

K. Relationship with Financial Institutions

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Financial institutions should be selected first and foremost with regard to their financial soundness and stability. Brokers should be recognized, reputable dealers. All cash and securities shall be held in either a bank that is allowable for the deposit of public funds, provided funds on deposit are insured by the Federal Deposit Insurance Corporation (FDIC), or in an Investment Brokerage Account that is insured by the Securities Investor Protection Corporation (SIPC).

The Treasurer/Custodian shall require any brokerage houses and broker/dealers, wishing to do business with the Town, to supply the following information to the Treasurer:

- Audited financial statements
- If acting as a Registered Investment Adviser, Form ADV Part II report
- Proof of FINRA membership
- Errors & Omissions insurance amounting to, at a minimum, the total fair market value of the trust fund's portfolio.
- A statement that the Investment Manager has read the municipality's IPS and will comply with it on an annual basis

L. Reporting Requirements

On a quarterly basis, a report containing the following information will be prepared by the Treasurer/Custodian distributed to the Finance Director and/or his/her designee as appropriate. The quarterly report will include the following information, as a minimum requirement:

- A listing of the individual accounts and individual securities held at the end of the reporting period.
- A listing of the short-term investment portfolio by security type and maturity to ensure compliance with the diversification and maturity guidelines established in the "Diversification" section of this IPS.
- A summary of the income earned on a monthly basis and year-to-date basis shall be reported.
- The Treasurer/Custodian shall include in the report a brief statement of general market and economic conditions and other factors that may affect the trust fund's cash position.
- The report should demonstrate the degree of compliance with the tenets set forth in the IPS.

M. Performance Measurement and Evaluation

- The Fund's performance will be measured by comparison with the stated objectives in comparison to the respective benchmarks.
- To monitor the intermediate term performance of the Fund, the Treasurer/Custodian will compare the Investment Manager's results to a blended benchmark, to be determined in conjunction with the Investment Manager(s).
- Rebalancing of the portfolios should happen at least annually or more frequently if appropriate.

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- It is expected that the performance figures of the trust fund, and any sub-strategy, will outperform the respective benchmarks, net of fees, on a long-term (business cycle) basis.

N. Supervision

- The Treasurer/Custodian will meet with the Investment Manager(s) as frequently as quarterly to monitor the performance of the Fund and the investment manager(s) compliance with these guidelines. The Treasurer/Custodian will receive and review portfolio management reports quarterly.
- The Treasurer/Custodian will review this Investment Policy Statement at least once a year to ensure that it remains appropriate and complete
- The Treasurer/Custodian has the option to put the management of funds out for bid periodically, and shall consider such option not less frequently than every five years, through a request for information, request for proposal, or similar process as required by law or Town policy.

O. Legal References

- Massachusetts General Law Chapter 32B, Section 20
- Massachusetts General Law Chapter 203C, Section 1 through 11