Investment Policy for the Retired Teachers' Health and Medical Benefits Fund and the Vermont State Employees Retirement System Other Post-Employment Benefits Trust Fund

December 29, 2022

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IX. Introduction

The Retired Teachers’ Health and Medical Benefits Fund (“VSTRS OPEB”) is established to pay retired teacher health and medical benefits, including prescription drug benefits, when due in accordance with the terms established by the Board of Trustees of the State Teachers' Retirement System of Vermont and administered by the Vermont State Treasurer. As per 16 VSA 55 § 1944b (d) the Treasurer may invest monies in the Benefits Fund in accordance with the provisions of 32 V.S.A § 434 or, in the alternative, may enter into an agreement with the Vermont Pension Investment Commission to invest such monies in accordance with the standards of care established by the prudent investor rule under 14A V.S.A. § 902, in a manner similar to the Commission's investment of retirement system monies.

The Vermont State Employees’ Retirement System Other Post-Employment Benefits Trust Fund (“VSERS OPEB’) is established for the purpose of accumulating and providing reserves to support retiree postemployment benefits for members, and to make distributions from the Benefits Fund for current and future postemployment benefits for retirees of the Vermont State Employees' Retirement System, excluding pensions and benefits otherwise appropriated by statute and for the payment of reasonable and proper expenses of administering the Benefits Fund and related benefit plans. As per 3 VSA 16 § 479a(c), the fund is administrated by the State Treasurer who may invest monies in the Benefits Fund in accordance with the provisions of 32 V.S.A. § 434 or, in the alternative, may enter into agreement with the Commission (Vermont Pension Investment Commission) to invest in accordance with the standards of care established by the prudent investor rule under 14A V.S.A. § 902, in a manner similar to the Commission’s investment of retirement system monies.

X. Statement of Purpose

The purpose of the Plans is to pay postemployment benefits to the members of the State Teachers’ Retirement System of Vermont and the Vermont State Employees’ Retirement System.

This Investment Policy serves as a guide for plan fiduciaries regarding the scope and purpose of the VSTRS OPEB and VSERS OPEB plans (the “Plans”), assign roles and responsibilities, outline investment return and risk objectives and constraints, and any other items that may help fiduciaries oversee plan assets. This document is intended to ensure prudence and care in the execution of the investment program. Deviation from this Policy is not permitted without explicit written permission from the Trustee. The Trustee shall direct Staff and its Investment Consultant to perform an annual review of this Investment Policy and, as needed, recommend appropriate modifications to the Trustee. The Trustee shall review this Investment Policy at least annually and, taking into account recommendations of the Investment Consultant, the Treasurer’s Office and the Office of the Attorney General, make modifications, which it, in its sole discretion, deems necessary.

XI. Core Beliefs

A. Plan assets shall be managed in a manner that adopts the appropriate amount of risk to have the highest probability of paying plan benefits.
B. The Plans shall maintain adequate liquidity to meet required premium payments to provide benefits to the OPEB beneficiaries.
C. The OPEB's annual asset allocation process determines the structure and composition of the portfolio.
D. The Trustee lacks the resources to devise, analyze and execute short-term tactical or market timing investment strategies, or to make direct investments in individual securities or individual real assets.
E. Decisions regarding specific asset classes, sub-classes, and investment managers are always considered within the context of the risk/return profile of the total portfolio.
F. Portfolio risk management is a central Trustee responsibility. The Trustee's most effective risk management tool is the diversification of Plan assets into various asset classes with differing, non-corelated risk drivers, and among various investment managers with differing, non-corelated market views. The number of investment managers must remain appropriate for the size of the portfolio.
G. The Trustee understands that unnecessarily high volatility has the potential to expose the portfolio to unacceptable market losses, which would be particularly critical with respect to the funded status and cash flow priorities of the Plans.
H. The Trustee relies on its investment consultant for investment manager due diligence and recommendations manager hiring and termination decisions.
I. The Trustee believes that well selected and monitored active investment managers can add value to the portfolio but recognizes that active management and strategy complexity also add potential additional risks and costs.
J. The Trustee believes that passive, indexed strategies are effective in highly efficient asset classes and sub-asset classes where active management is unlikely to provide attractive risk adjusted returns after management fees.
K. The Trustee believes that until the OPEB grows to a sufficient size, the use of commingled funds is preferred to separate accounts when commingled funds exist to meet the OPEB's investment goals.
L. The Trustee recognizes the high frictional cost of switching investment managers and understands the perils of hiring or terminating managers based on recent investment performance.
M. To the extent possible, the Trustee's investment decision-making is driven by data and analysis, including the findings of the financial market and investment management literature.
N. The Trustee believes that a disciplined investment process is essential to developing a long-term sustainable investment advantage, and that a disciplined process helps avoid the very human tendency to engage in reactive investment

decision-making driven by emotion, the latest news, investment fads, or conventional wisdom.

O. The Trustee strives to be a thoughtful, analytical, and patient investor.

XII. Allocation of Responsibilities

A. Trustee

The OPEB employs a governance framework that ensures that all of its fiduciary and legal responsibilities are addressed on an ongoing basis. The Trustee focuses its time on its three core responsibilities: asset allocation, risk management, and governance. All other responsibilities are largely delegated: to VPIC, investment managers, a proxy voting vendor[1], OPEB's master custodian, OPEB's investment consultant, Treasurer's office staff, and the Vermont Attorney General's office. The Trustee has operating policies in place to manage these delegated responsibilities, and the Trustee receives reports and responds to recommendations from staff and from its investment consultant.

B. Investment Consultant

The Investment Consultant is hired by the Trustee, reports directly to the Trustee, and is directly accountable to the Trustee. The Investment Consultant serves to provide assistance in developing, executing and monitoring the investment program of the Plans. The duties of the Investment Consultant include providing investment education, analysis and advice regarding asset allocation, investment policy development, asset class and manager structure, manager selection, and ongoing performance monitoring and due diligence.

Investment results will be reported by the Investment Consultant on a regular basis and reported to the Trustee as soon as practicable after each calendar quarter.

C. External Investment Managers

External Investment Managers (Managers) are selected by and serve at the pleasure of the Trustee. Each investment manager shall be a registered adviser under the Investment Advisers Act of 1940 (or appropriately exempt from registration), a regulated bank, an insurance company or a mutual fund organization, though certain exceptions may be made by the Treasurer for investments in private markets. Investment Managers will operate under a formal contract that sets investment guidelines and administrative requirements and defines responsibilities and performance expectations for management of each mandate. Full discretion, consistent with this policy and contractual guidelines, is granted to all investment managers. Managers will provide performance

[1] As the OPEB does not currently utilize separate accounts, a proxy voting vendor has not been engaged.

reporting to the Trustee utilizing standardized reporting formats and at intervals specified by the Trustee.

D. Custodian

The Trustee shall retain a bank or trust company to act as custodian for the plan assets. Such custodian shall be responsible for the safekeeping of all Plan assets put under its custody, as well as the regular valuation of Plan assets and settlement of investment managers' trades on behalf of the Plan.

Services performed by the Custodian shall include safekeeping of securities, collection of all interest and dividends, daily sweep of idle cash balances, accepting trading/cash reconciliation instructions from managers, providing monthly accounting statements, and other core custodial functions necessary for the effective safekeeping, valuation, and administration of Plan assets. The Custodian shall also provide electronic monitoring of each separately managed account for compliance with the applicable contractual investment guidelines.

E. Vermont Pension Investment Commission ("VPIC")

On September 30th, 2022, The Trustee entered into a Memorandum of Understanding (MOU) regarding the investment of OPEB monies in the Portfolio. This agreement is located at:

http://www.vermonttreasurer.gov/content/cash/other-post-employment-benefit-investments

It outlines the roles and responsibilities of the Vermont Pension Investment Commission (VPIC) as it relates to OPEB. The below policy expands on that memorandum and should be read in unison with the MOU.

In accordance with the Memorandum of Understanding between the Trustee and VPIC, the Trustee will:

1. Identify assets in the Benefits Fund and provide VPIC with an explanation as to how the Treasurer desires the Benefits Fund to be invested.
2. Assist VPIC and provide any documents that VPIC may reasonably require in order for VPIC to identify and facilitate investment of the Benefits Fund in existing investment vehicles that are appropriate for investment of the Benefits Fund and consistent with the objectives set forth by the Treasurer.
3. Work together with VPIC in investigating new investment vehicles that may permit investment of assets of the Benefits Fund alongside the investment of assets of the retirement systems.
4. Select and make investments of assets of the Benefits Fund.

VPIC agrees it will:

1. Identify, by vote of the Commission, existing investment vehicles that can be made available for investment of the Benefits Fund, consistent with the objectives set forth by the Treasurer.
2. Facilitate discussions and negotiations with investment managers and trustees of collective investment trusts of those investment vehicles selected by the Treasurer, and where reasonable and prudent in the interest of the funds directly invested by VPIC, leverage additional State investment for fee and term concessions beneficial to both parties.
3. Work together with the Treasurer in investigating new investment vehicles that may permit investment of the Benefits Fund alongside the investment of assets of the retirement systems.

XIII. Asset Allocation

The Trustee recognizes that over the long-term, asset allocation is the single greatest determinant of return and risk to the Plans. Asset allocation policy is intended to reflect, and be consistent with, the return objective and risk tolerance appropriate to meet the Plan objectives. It is designed to provide the highest probability of meeting or exceeding Plan objectives at a controlled level of risk that is acceptable to the Trustee. In determining the appropriate strategic allocation among asset classes, the Trustee, with assistance from Staff and the Investment Consultant will examine the historical and projected risk and return profiles of various asset classes as well as the correlation among those asset classes. The strategic asset allocation policy will be selected and updated through an annual portfolio asset allocation and investment strategy development process.

A. Strategic Asset Allocation Targets

Strategic Asset Allocation Targets can be found in *Appendix A: Strategic Asset Allocation Targets.*

B. Rebalancing Policy

The purpose of rebalancing is to maintain the risk/reward relationship implied by the Trustee-approved long-term asset allocation targets. The State Treasurer's Office shall implement rebalancing as set forth below and Investment Managers and the Custodian Bank will be directed to transfer funds to rebalance the assets under management as necessary.

A review of the need for rebalancing of the OPEB Portfolio will be conducted on a quarterly basis and as needed in response to market fluctuations. Asset class or manager deviations from the target policy of greater than a twenty percent (20%)

relative deviation will be candidates for rebalancing. Notice of anticipated cash flow needs will be provided to the Investment Managers in accordance with the terms of the respective Investment Manager contracts. When the allocation to all asset classes remains within these limits, Staff will use cash flow to maintain the overall allocation as close as possible to the target.

While using its discretion, and as part of the normal rebalancing process, the Treasurer's Office will consider the unique characteristics of each asset class, the degree of overweight/underweight, liquidity characteristics, current market conditions, transaction costs, and any other relevant considerations to ensure prudence and care.

C. Asset Class Categories

The OPEB Plans recognize three thematic asset class categories: Growth, Inflation Hedging, and Downturn Hedging. The characteristics of these three general categories, and the specific type of investments within each general asset class are discussed in greater detail below. The OPEB asset classes are defined by differences in their expected response to economic conditions, such as economic growth and price inflation. The OPEB uses these asset classes in such a way as to maximize the total return on investment, within acceptable levels of risk for public retirement systems, subject to fundamental diversification and liquidity constraints. It is understood that some of the investments of the OPEB Plans could bridge across multiple Asset Class Categories, however the mapping in Appedix A reflects the predominant investment characteristic.

Growth

Growth investments include both public and private equities, private credit, and emerging markets debt. These investments are included in the portfolio for capital appreciation over the long term, with a higher degree of expected volatility. Equities performance over the long-term is largely a function of earnings and dividend growth while private credit and emerging markets debt provide increased return opportunities via a higher exposure to credit relative to core fixed income.

Inflation Hedging

Inflation Hedging assets include TIPS and Real Estate. TIPS are directly tied to inflation and real estate tends to see increased valuations and property rental income during inflationary periods. While some assets such as equities may have inflation hedging characteristics, they are more focused on long term capital appreciation.

Downturn Hedging

Core Bonds are the only investment included in downturn hedging assets as they are viewed as potentially attractive due to their historically lower volatility and diversification characteristics (relative to equities), as well as their income-producing nature. These characteristics are typically considered beneficial in environments characterized by low growth and low inflation.

VI. Investment Performance Measurement

A. Total Fund Benchmarks

Policy Index Return

The Policy Index Return shall measure the success of the Portfolio's target allocation. It shall be calculated by using index rates of return for each asset class invested in by the VPIC Portfolio multiplied by the percent targeted to each asset class.

Allocation Index Return

The Allocation Index Return shall measure the success of the VPIC Portfolio's current allocation. It shall be calculated by using index rates of return for each asset class invested in by the VPIC Portfolio multiplied by the actual percent allocated to each asset class. The difference between the Allocation Index Return and the Policy Index Return measures the effects of deviating from the target allocation. If the Allocation Index Return is greater than the Policy Index Return, then deviating from the target allocation has added value. If the Allocation Index Return is less than the Policy Index Return, then deviation has not added value.

The difference between the Allocation Index Return and the total portfolio return measures the effect of active management. If the total portfolio return is greater than the Allocation Index Return, then active management has in aggregate added value. If the total portfolio return equals or is less than the Allocation Index Return then active management has not added value.

B. Asset Class and Investment Manager Benchmarks

The Trustee, with the consultation of the Investment Consultant, sets benchmarks for assessment of performance of each type of investment invested in by the Plans. Each benchmark must be definable in advance, representative of the specific asset class and the desired exposure within that asset class and readily measured with widely available historical data. The Trustee shall require the Investment Consultant to prepare quarterly performance comparisons to reflect the performance of each investment type's benchmark and performance of the portion of the Plans allocated to the investment type. To the extent that multiple managers are used for an investment type, the appropriate benchmark for the manager shall be reported as well. Each benchmark, to the extent available for a specific investment, shall be incorporated in each investment management agreement as the basis for evaluation of performance.

The long-term performance benchmark for each investment type is shown in *Appendix B: Asset Class Benchmarks.*

VII. External Investment Management

A. Asset Management Implementation

In all cases, the investment function will be outsourced to managers that have the experience and resources to do thorough risk and securities analysis within the asset class or strategy that they specialize in. Assets may be held in privately managed separate accounts and/or commingled funds, including membership in limited liability companies, limited partnerships, acquisition of shares in collective investment funds and other fund structures. Exposure through commingled funds shall be evaluated on a case-specific basis through analysis of the fund's "offering document" and the instruments establishing the fund.

In all cases, the Trustee, in consultation with the Investment Consultant and Staff, shall review and approve the specific investment guidelines for that investment prior to contract execution.

Each investment manager will function under a formal contract that delineates its responsibilities, performance expectations, administrative requirements, investment guidelines and management fee.

B. Investment Manager Search and Selection

The investment services selection process shall be open, competitive, and objective and designed to ensure that the plans have access to a broad array of the highest quality service providers that have the experience and capabilities to provide investment and investment-related services to the plans.

The Trustee may direct the Investment Consultant to conduct data-base searches or public requests for proposals for investment managers and investment products, considering advice from the Investment Consultant, at the time of authorization. The Investment Consultant may be directed to coordinate and summarize the findings of a search. The Trustee with the assistance of VPIC, per the MOU, shall be responsible for reviewing the qualified vendor responses in consultation with the Investment Consultant and Treasurer's Office Staff as appropriate.

Interviewing finalists and Investment Manager selection will be conducted by the Trustee and Staff. Each respective Investment Manager shall be required to provide the Trustee with a detail of its proposed investment guidelines.
All contract terms shall be consistent with this Investment Policy. Contract summaries of each Investment Manager contract shall be made available on the Treasurer's website.

C. Investment Manager Monitoring and Evaluation

The Trustee, with support from the Investment Consultant and the Staff, shall monitor and conduct on-going due diligence on each Investment Manager.

The Investment Manager Monitoring process is primarily delegated to Treasurer's Office staff and the Investment Consultant who are responsible for advising the Treasurer of (i) deviations from specific Investment Manager investment strategy and process, (ii) changes to key personnel responsible for portfolio management, (iii) organizational stability and whether performance meets applicable benchmarks.

Investment Manager monitoring shall include, at a minimum:

a. Annual self-reporting by each Manager on contract compliance;
b. Electronic monitoring by the OPEB Custodian of each separately managed account for compliance with the applicable contractual investment guidelines;
c. Periodic site visits to the Investment Manager's premises by the Investment Consultant to confirm that the infrastructure is in place to support the investment process;
d. Review of Investment Manager reporting by the Treasurer's Office Staff and the Investment Consultant;
e. Quarterly presentation by the Investment Consultant of a comprehensive investment performance review for all Investment Managers, as well as for the OPEB Portfolio as a whole.
f. Portfolios shall be measured over various and appropriate time periods. The Trustee may consider multiple factors influencing Investment Manager performance and attempt to discern style differences from manager over/underperformance.

Attainment of investment objectives does not guarantee continued employment by the Trustee nor does failure to achieve these guidelines ensure dismissal. Investment Managers serve at the discretion of the Trustee.

VIII. Policy Constraints

When selecting Investment Managers, the Trustee, working with VPIC shall consider the following guidelines:

A. Full Investment

The Portfolio is expected to be fully invested. No more than 10% of any Investment Manager's allocation may consist of cash, or cash equivalents. "Cash and Cash equivalents" may include bank accounts, imprest cash, short-term investments with an original maturity of 3-months or less such as certificates of deposit, commercial paper, federal government agencies' discount notes, money market accounts, and repurchase agreements.

B. Liquidity

Consistent with the need to maintain adequate liquidity to meet required benefit payments to the beneficiaries of the Retirement Systems, the Treasurer's Office will review the liquidity requirements of the Portfolio on a periodic basis, as well as immediately prior to the execution of any contract with "lock-up" or similar provisions.

C. Liability

While certain Investment Managers may use leverage in accordance with their respective contract terms, in no event shall the financial exposure of the Portfolio in any one investment exceed 100% of such investment.

D. Professional Standards and Ethics

Each Investment Manager shall be required to demonstrate a commitment to professional standards and ethics by employing Chartered Financial Analysts and by adhering to either the CFA Institute Asset Manager Code of Professional Conduct or a reasonably similar set of standards.

E. Environmental, Social and Governance Initiatives

All opportunities to either make or divest from investments for the purpose of achieving certain environmental, social or governance goals that do not appear to be primarily investment-related ("Environmental, Social and Governance (ESG) Initiatives"), shall be evaluated in accordance with the VPIC ESG Policy, as the same may be amended from time-to-time, which may be found on the VPIC's website at :

https://outside.vermont.gov/dept/VPIC/Shared%20Documents/VPIC%20Website/VPIC%20Policies/VPIC_ESG_Policy%5B1%5D.pdf

IX. Risk Management

A. Operational Risk Management

Treasurer's Office staff shall seek to minimize the operational risks associated with the custody and investment of assets. Staff will assess in an ongoing manner the performance of the Custodian and investment managers as it relates to timeliness and completeness of reporting, responsiveness to support requests, compliance with cash flow directives, etc. Any concerns regarding the safety of the assets at either the Custodian or in the care of an investment manager, as well as any concerns over operational controls will be brought to the attention of the Trustee and Investment Advisor immediately.

B. Portfolio Level Risk Control procedures

Treasurer's Office staff, in conjunction with the investment managers and the Investment Consultant, will periodically conduct portfolio-level risk analytics such as an up/down market sensitivity study, factor analysis, stress testing, scenario analysis, drawdown review, or other assessments of portfolio risk as capabilities allow.

C. Contract Compliance

Each investment manager is expected to adhere to its respective contractual investment and reporting guidelines. However, an Investment Manager may from time-to-time request a waiver for temporary deviations from its contractual Investment Guidelines along with a plan for coming back into compliance within a period of time. For example, a request may be made as the result of a downgrade in credit rating, or overweighting relative to permitted tolerances. Waivers can only be approved by the Trustee.

X. Special Issues Relating to Separate Accounts[2]

A. Best Execution

All investment management agreements shall require that trades must be done on a "best execution" basis.

B. Conflicts of Interest

The use of brokers in which an Investment Manager has a financial interest shall be prohibited, except that OPEB index, money market and transition management accounts managed by divisions or wholly-owned subsidiaries of the OPEB's Custodian Bank may use the Custodian Bank's broker-dealer division or

[2] The OPEB's currently do not have, nor intend to invest through separate accounts where commingled funds are available, until the funds have reached sufficient size, as stated in the Core Beliefs.

wholly-owned subsidiary, subject to obtaining best execution.

C. *Tobacco*

Investment Managers investing Portfolio assets in privately managed separate accounts are prohibited from purchasing the securities of companies whose primary source of revenue is derived from the production and sale of tobacco products.

D. Proxies

The VPIC has adopted Domestic and International Proxy Voting Guidelines, which are available at: https://outside.vermont.gov/dept/VPIC/Shared%20Documents/VPIC%20Website/VPIC%20Policies/VPIC_Domestic_Proxy_Voting_Policy%5B1%5D.pdf and https://outside.vermont.gov/dept/VPIC/Shared%20Documents/VPIC%20Website/VPIC%20Policies/VPIC_International_Proxy_Voting_Policy%5B1%5D.pdf The OPEB Plans will adhere to this policy. All proxies shall be voted in accordance with applicable State law and VPIC policy, as more specifically described below.

E. Burma (Myanmar)

In accordance with Section 3(a) of Act No. 13 of the Vermont General Assembly (1999 Sess.), the VPIC shall vote in favor of —shareholder resolutions filed by shareholders when those resolutions raise concerns about doing business in Burma, including requests: (1) to report on company activities in Burma; (2) to report on the full costs of doing business in Burma; (3) to address human rights or drug trafficking conditions in Burma; or (4) to establish human rights guidelines.

F. MacBride (Northern Ireland)

In accordance with Act No. 50 of the Vermont General Assembly (1989 Sess.), Investment Managers shall provide the VPIC with a list of corporations that directly, or through a subsidiary, do business in Northern Ireland and in whose stocks or obligations the VPIC has invested and shall advise the VPIC whether each corporation has achieved the goals known as the MacBride principles. At every reasonable opportunity VPIC shall support shareholder resolutions designed to encourage United States corporations doing business in Northern Ireland in which the VPIC Portfolio is invested to adopt and implement the MacBride principles.

G. Investments in Terrorist or Genocide Linked Countries

Investments shall be restricted or prohibited in certain countries engaged in the sponsorship of terrorism or genocide or in companies which support a government or government-associated group or entity engaged in terrorist or genocidal activities, in accordance with the VPIC Policy on Investments in Terrorist or Genocide-Linked Countries, as the same may be amended from time-to-time, which may be found on the VPIC's website at :

https://outside.vermont.gov/dept/VPIC/Shared%20Documents/VPIC%20Website/VPIC%20Policies/VPIC_Policy_on_Investments_in_Terrorist_or_Genocide_Linked_Countries%5B1%5D.pdf

Appendix A: Strategic Asset Allocation Targets

Asset Class	Target Allocation	Asset Category	Target Allocation
Global Equity	43%	Growth	67%
Emerging Markets Debt	4%		
Private & Alternative Credit	10%		
Private Equity	10%		
Core Bond	19%	Downturn Hedging Assets	19%
US TIPS	3%	Inflation Hedging Assets	14%
Real Estate	11%		
Total	100%		100%

Appendix B: Benchmarks

Asset Class	Benchmark
Global Equity	MSCI ACW IM Index (Net)
Emerging Markets Debt	JPM Emerging Markets Bond Global Index
Private & Alternative Credit	Credit Suisse Leveraged Loan Index +2%
Private Equity	Cambridge US Private Equity Index
Core Bond	Bloomberg US Agg Bond Index
US TIPS	Bloomberg US TIPS Index
Real Estate	NCREIF ODCE Index