City of San José
Deferred Compensation
Investment Policy Statement

Adopted March 2011

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I) INTRODUCTION

A) **Purpose of Investment Policy Statement.** The purpose of this Investment Policy Statement is to record the investment objectives and investment policies for the City of San José 457 Deferred Compensation Plan (the "Plan"). The City of San José Deferred Compensation Advisory Committee (the "Committee") has the responsibility to administer and provide oversight of the Plan. The Committee may designate a subcommittee to act on its behalf. The purpose of the Plan is to provide a vehicle for retirement savings. This Investment Policy Statement supersedes any other Investment policy or guidelines previously adopted by the Committee. It is intended to assist the Committee in meeting its fiduciary responsibility by:

- effectively constructing, supervising, and evaluating the investment program established for the Plan, and by
- establishing a framework for the selection, monitoring, and evaluation of the Plan's investment fund managers.

This policy is intended to be flexible, and the Committee shall be free to deviate from this policy as it deems appropriate.

ERISA 404(c) Safe Harbor Compliance. Although the Employee Retirement Income Security Act of 1974 (ERISA) does not apply to the Plan, in recognition of the intent of ERISA, other legislation and regulatory guidance, and the trend of retirement plan convergence, the Committee intends to operate the plan generally in conformance with ERISA 404(c). Investment decisions made by the Committee or designated subcommittee will be made for the sole interest of the participants and beneficiaries of the Plan.

This statement is an outline of the Committee's general investment policies and intended to supersede any earlier statement(s) of investment policies and objectives effective with the date this statement is executed. The Policy may be reviewed annually and revised any time as necessary to ensure it adequately reflects changes related to the Plan. This document is intended to be a 'living document' and is intended to be easy to change. The most commonly modified aspects of policy, such as benchmarks and fund options, are included as appendices.

It is understood that there can be no guarantees about the attainment of the goals or investment objectives outlined herein.

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B) Plan Objective. The Plan was established to provide eligible employees an opportunity to accumulate funds for retirement in addition to any other retirement benefits they may be eligible for. The Plan is a deferred compensation plan that provide for benefits based solely on the amount contributed to each participant's account plus or minus any income, expenses, and gains or losses.

C) Investment Option Menu

1) Purpose of Investment Options

a) Consistent with ERISA 404(c), investment options are selected to provide participants with an opportunity to diversify their accounts across a reasonable risk and reward spectrum.

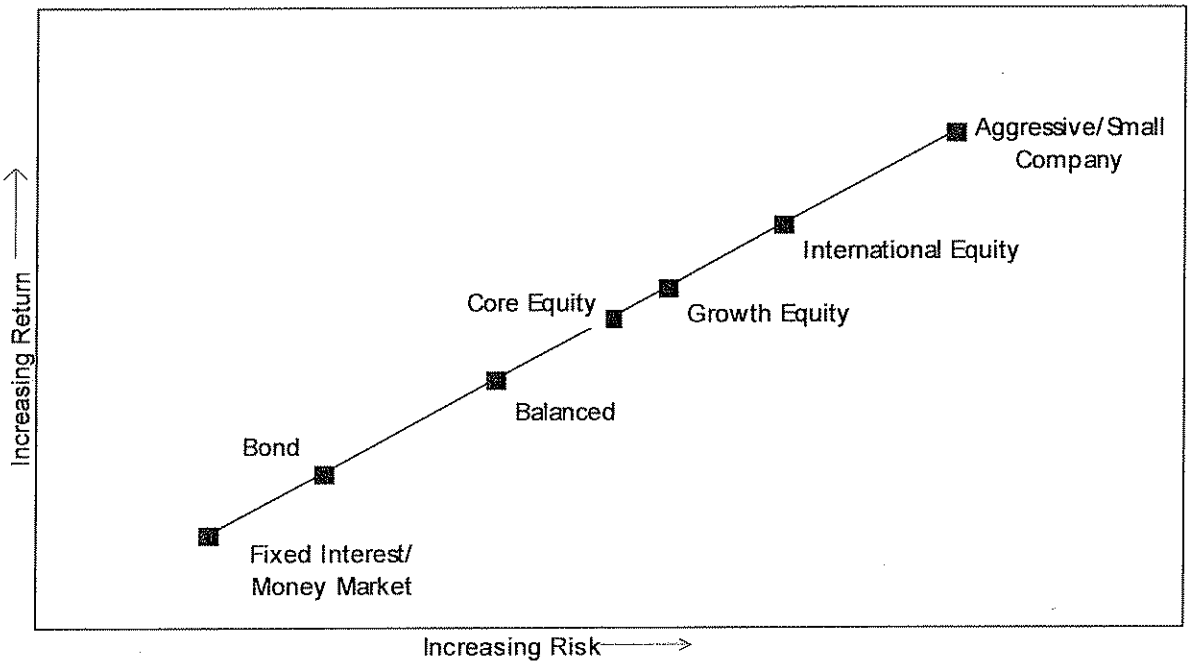
b) Participants may select from a combination of investment options and may change the asset allocation of their investments pursuant to the Plan provisions and administrative procedures.

2) Construction of the Investment Option Menu

a) The number and types of investment options and the investment fund managers retained to manage the investment options are subject to change based upon the Committee's on-going review and evaluation of the investment menu offered to participants.

b) The Committee or designated subcommittee may add, replace, or remove investment options or funds at any time when it concludes such a change is in the best interests of Plan participants and beneficiaries. Investment Options are found in Appendix A.

Conceptual Relationship of Investment Options Relative to Risk and Return



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II) STATEMENT OF RESPONSIBILITIES

A) Committee

The committee will discharge its duties under this policy solely in the interest of the participants and beneficiaries. The Committee members are to perform their duties with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. The Committee may designate one or more subcommittees to act on its behalf.

Committee members' responsibilities include but are not limited to:

1) Selecting the investment design features of the Plan, including:
   a) drafting the Investment Policy,
   b) determining the number and types of investment alternatives available to Plan participants, and
   c) developing Participant investment procedures with Plan record keeper.

2) Selecting, monitoring, and evaluating all investment funds in accordance with this Investment Policy.

3) Monitoring Plan costs which are charged to Plan assets and or paid by Plan participants, including but not limited to investment management fees, and fees paid to other Plan service providers from Plan assets.

4) Providing general investment information to Plan participants regarding the procedures for making investment choices under the Plan and general investment information regarding each of the investment options offered under the Plan. This function may be delegated to staff and/or Plan record keeper.

B) Investment Managers

At present, the Plan primarily utilizes mutual funds as Plan investment vehicles. The Committee or designated subcommittee may select separately managed accounts, collective trusts, commingled pooled funds, and any other funding vehicles as it deems appropriate for use by the Plan. These various funding vehicles and approaches are collectively and interchangeably referred to using the term 'investment manager': investment funds, investment fund managers, investment products, mutual funds, and/or registered investment advisors within this policy.

1) Standards of Investment Managers. This section describes the standards to which Investment Managers should be held by the Committee or designated subcommittee when initially selected and while performing investment management services.

   a) Investing Plan assets with the care, skill, prudence, and diligence that would be applied by a prudent professional investor, acting in like capacity and knowledgeable in the investment of retirement funds.
   b) All transactions undertaken on behalf of the Plan shall be for the sole interest of Plan participants and beneficiaries.
   c) With respect to the use of mutual funds or collective trusts, the Committee expects assets of such funds to be invested in accordance with the applicable prospectus, purchase agreement, and/or declaration of trust.
   d) All mutual funds shall be registered Investment Companies as defined under the Investment Company Act of 1940 (the "Act"). The Investment Companies need not be classified as "diversified" Investment Companies as defined in the Act.

C) Plan Participants

Investment, contribution, and allocation decisions shall be made solely by each Plan participant subject to certain procedural and administrative guidelines and default investment procedures for participants that do not make an investment election. The Committee shall make available investment option performance results and may make available other educational information relating to investment concepts and the investment options. This function may be delegated to staff and/or Plan record keeper. The provision of this information does not constitute investment advice.

The Committee or designated subcommittee may engage service providers, who in the provision of their services to the Plan and its participants, will provide investment advice. Such service providers must acknowledge in writing that they are assuming fiduciary responsibility for that advice. It is solely the responsibility of each Plan participant to direct the investments in his or her account.

Participant responsibilities include but are not limited to:

1) Determining their contribution/deferral rate.
2) Selecting their investment options for both existing balances and new contributions going forward.
3) Monitoring their asset allocation strategy and making adjustments as personal situations change.
4) Electing the timing and form of distributions according to terms of the Plan.

D) Plan Administrator

The Committee is also the plan administrator. The plan administrator's duties include but are not limited to:

1) Administering and interpreting the provisions of the Plan.
2) Making available to Plan participants a Plan summary.
3) Providing Plan participants with an annual statement of account.
4) Compliance with all laws and regulations governing the Plan.
5) Delegating various functions or tasks to individual employees or service providers.

E) Investment Consultant

The investment consultant's role is to serve as an independent and unbiased fiduciary that provides information and advice to the Committee or designated subcommittee as a fiduciary to the Plan.

The primary function of the investment consultant is to inform and advise the Committee on various investment-related issues with respect to the Plan. Such services include but are not limited to:

1) Assisting the Committee with developing an appropriate structure for the investment menu.
2) Providing timely and accurate reports evaluating the return, risk, and characteristics of each of the funds compared to appropriate indexes and/or peer group universes.
3) Apprising the Committee of changes with regard to their funds in a reasonable time frame given the significance of the information.
4) Conducting a fund review at the request of the Committee when, for example, noteworthy changes or significant underperformance occurs.
5) Assisting the Committee in the search and replacement of existing funds as needed.

F) Record keeper

The record keeper has no discretionary authority over the Plan and its assets and is not a fiduciary with respect to the Plan. The record keeper's responsibilities include but are not limited to:

1) Maintaining the Plan participant account balances in an accurate and confidential manner.
2) Preparation of participant statements.

3) Completion of the annual compliance tests as included in its service agreement.
4) Providing accurate and timely Plan data and reports to the Committee as included in its service agreement.
5) Providing participants with electronic access to account information and transactions as contracted by the Committee.
6) Coordination of the provision of fund prospectuses to participants as requested.
7) Provision of various participant communication materials as described in its service agreement and/or requested by the Committee.

G) Trustee/Custodian

The trustee/custodian is non-discretionary and takes direction from the Committee or designated subcommittee. The trustee has fiduciary responsibility with respect to the Plan assets under its control. The trustee's responsibilities include but are not limited to:

1) Safekeeping all securities.
2) Settling transactions.
3) Receiving contributions.
4) Allocating contributions among investment accounts as instructed.
5) Making participant distributions as instructed.
6) Providing periodic account statements to the Committee or designated subcommittee and other service providers as requested by the Committee or designated subcommittee.

III) COMMITTEE PROCESS

A) Meeting Frequency. The Committee or designated subcommittee will review the investment performance of the funds offered in the Plan no less frequent than semi-annually. The Committee or designated subcommittee will also review the investment policy and investment options offered in the plan on an annual basis. The Committee may choose to meet on a more frequent basis (e.g., monthly, bi-monthly, or quarterly). The Committee may designate one or more subcommittees which may meet periodically.

B) Investment Manager Selection. Searches for investment managers and funds should include candidates that have demonstrated success in similar assignments. In selecting an investment manager, a due-diligence process is followed, which analyzes the investment fund including but not limited to the following characteristics:

1) Investment performance track record and consistency of returns achieved with risks taken
2) Alignment of fund investment philosophy, process, and style with plan option objectives
3) Size and experience of professional staff
4) Tenure of stability of investment management team and parent organization
5) Fees
6) Compatibility with plan trading requirements
7) An assessment of fund statistics measuring risk related to its benchmark

C) **Investment Fund Performance Evaluation.** Performance benchmarks and peer groups will be established for each fund and/or asset class. The performance review will include measuring the funds' investment performance to stated benchmarks and peer groups, as well as monitoring risk measures and other factors utilized in section III B above. In addition, the following general criteria will be the basic standard of satisfactory performance:

1) Quantitative Measures.

a) Active Investment Strategies. Funds employing active management are expected to outperform their benchmark or peer group, and preferably both, over trailing periods of three years and longer.
b) Passive Investment Strategies. Passive Funds are expected to track the performance of the index strategy that the option is designed to replicate, less management fees, with minimal tracking error.

Benchmarks are found in Appendix A.

2) Qualitative Measures.

The funds will also be monitored on an ongoing basis for other material changes which the Committee or designated subcommittee may determine are of importance to the decision to retain an investment fund, including but not limited to:

- personnel departures
- organizational changes
- alterations in investment style, philosophy, or strategy
- significant changes in assets under management
- significant increase in fund expenses/costs

4) Time Periods.

The Committee acknowledges that fluctuating rates of return characterize the securities markets, particularly during short-term time-periods. Recognizing that short-term fluctuations may cause variations in a fund's performance, the Committee intends to employ investment funds with long-term investment strategies and will evaluate fund performance from a long-term perspective. Performance over three, five and ten year periods will be weighed more heavily than performance over shorter time periods such as one year or less.

D) **Investment Fund Termination and Watch Status.** The Committee recognizes the long-term nature of retirement plan investing and the variability of market returns. Periodic underperformance in any of the criteria outlined in this policy will not necessitate the termination of a fund. Underperformance will provoke thoughtful consideration by the Committee of the factors causing underperformance and possible courses of action that the Committee may take, including termination.

Criteria for placing a fund or investment option on the Watch List, as well as criteria for evaluating the Watch List, are located in Appendix A.

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VI. ADOPTION & SIGNATURE:

AS APPROVED BY THE DEFERRED COMPENSATION ADVISORY COMMITTEE ON MARCH 17, 2011:

Kay Winer

Kay Winer, Acting Human Resources Director
Deferred Compensation Advisory Committee Secretary
City of San José

3/24/11
Date

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Appendix A: Investment Options, Benchmarks, and Watch List criteria

Description of Investment Option Categories

Asset allocation, quality, and sector concentration guidelines will be dictated by the stated policies of the manager or prospectus of a fund.

A **Money Market Option** invests in cash equivalent securities with maturities of less than one year. The average quality of the portfolio must be A1, P1, or AAA. The objective of the fund is to protect underlying principal value and produce a reasonable level of current income. While the volatility risk of this option is the lowest, accumulation risk is the highest. A money market fund may not be necessary if the stable value options do not have restrictions on interfund transfers from the stable value fund to other funds in the portfolio.

A **Stable Value, General Account or Fixed Account Option** invests in book value investments which may include General Account annuity products, Separate Account products, Guaranteed Accumulation Accounts (GAAs), Guaranteed Investment Contracts (GICs), Bank Investment Contracts (BICs), "Synthetic" GIC arrangements and money market instruments, and may invest in intermediate term fixed income securities. Investments may either be made directly or through pooled arrangements. The objective of the fund is to provide higher income than a money market fund while still providing no fluctuation in principal value.

An **Intermediate-Term Bond Option** invests in cash equivalents and marketable fixed income securities. The portfolio may have an average duration that is short, intermediate or long term. The fund is expected to primarily invest in investment grade securities, with a minimum of 80% of assets invested in securities rated BBB or higher. The average portfolio quality shall be A or better as rated by Standard & Poor's or may have a comparable rating or better by other rating companies, such as Moody's or Fitch's. Sector and issue concentration guidelines will be dictated by the stated policies of the manager of the fund(s) and may include non-U.S. issuers. The investment objective is to provide longer term preservation of capital while earning a high level of current income. However, principal values may fluctuate over time, primarily in response to changes in interest rates and /or other economic conditions that may affect the capital markets.

An **International Bond Option** invests in bonds issued by foreign governments and corporations based out of the United States. In addition to the risks typically associated with fixed-income investments, this investment option is also subject to risks of changing currency exchange rates, possible sovereign defaults, credit conditions in international fixed income markets as well as other risks.

A **Treasury Inflation Protected Securities (TIPS) Option** invests primarily in inflation-linked bonds issued by the United States Treasury. The fund may invest up to 20% of its portfolio in non-TIPS bonds such as ordinary treasury bonds, corporate bonds

or international bonds.

A **Large Capitalization (Large Cap) Option** invests in those companies that comprise the top 70% of the overall stock market capitalization. This asset class may contain value funds that invest in stocks of companies the investment fund manager believes the stock market undervalues and has the potential for market appreciation. This asset class may also contain growth funds that invests in stocks of companies the fund manager believes will grow at a faster rate than its peers or the corresponding market. This asset class may include funds that are blended to include both value and growth stocks. Stocks in this asset class may provide additional investment growth through the reinvestment of dividends.

A **Medium Capitalization (Mid Cap) Option** invests in companies that comprise the next 20% of the overall stock market. This asset class may contain value funds that invest in stocks of companies the investment fund manager believes the stock market undervalues and has the potential for market appreciation. This asset class may also contain growth funds that invests in stocks of companies the fund manager believes will grow at a faster rate than its peers or the corresponding market. This asset class may include funds that are blended to include both value and growth stocks. Mid-sized companies may be less able to weather economic shifts or other adverse developments than larger, more established companies.

A **Small Capitalization (Small Cap) Option** invests in companies that comprise the remaining 10% of the overall stock market capitalization. This asset class may contain value funds that invest in stocks of companies the investment fund manager believes the stock market undervalues and has the potential for market appreciation. This asset class may also contain growth funds that invests in stocks of companies the fund manager believes will grow at a faster rate than its peers or the corresponding market. This asset class may include funds that are blended to include both value and growth stocks. Small-sized companies may be less able to weather economic shifts or other adverse developments than larger, more established companies.

An **International Equity Option** invests primarily in common stock of non-U.S. issuers. This fund can be expected to be subject to risk factors not prevalent in domestic markets, including currency risk. Investment funds in this category may focus on developed markets, developing markets or a combination of the two.

An **Index Fund Option** invests identically or nearly identical to the market index whose return it seeks to duplicate. The objective of an index fund is to provide market diversification and a market average rate of return reflective of the market segment represented by a given index, e.g., the Standard & Poor's 500.

Asset Allocation Funds (Model Portfolios) offer an allocation of investments, principally stocks, bonds, and cash or cash equivalents, which are appropriate for a given stage or age of an individual's investment lifecycle. An aggressive asset allocation fund

or an age targeted fund with a longer timeframe will have greater weighting in stocks than a moderate or conservative asset allocation fund or age targeted fund with a shorter timeframe. A conservative asset allocation fund will be more heavily weighted toward current income and protection of capital. The objective of an asset allocation fund is to provide a composite rate of return from current income and capital appreciation which is appropriate for a given stage of an individual's investment life cycle. The investment objective is to provide a diversified investment return of current income and capital appreciation.

Asset Allocation category may include balanced funds, risk based lifestyle funds and/or time/age based life-cycle funds.

Socially Responsible Investing ("SRI") Option is a mutual fund that has SRI as a stated prospectus objective and which attempts to invest in companies with sustainable business models without compromising investor returns. SRI funds combine thorough financial analysis with environmental, social and corporate governance ("ESG") screening. Although screening criteria varies across the SRI fund universe, these funds will generally avoid companies that are significantly involved in the manufacture of weapons or weapons-related products, manufacture tobacco products, are involved in gambling as a main line of business, or engage in unethical business practices. In addition to these traditional SRI screens, these funds may look for companies that have positive impacts on the environment, fair workplace practices, robust corporate governance, high product integrity and positive community involvement.

The DCAC may decide to provide one or more Socially-Responsible Investment (SRI) options in the list of core options, for Participants that are interested in this style of investment choice. SRIs may be categorized in various asset classes. The SRI must remain competitive to its specific asset class and will be subject to investment analysis and potential replacement in the ongoing fund review process. Additionally, the SRI fund must also adhere to its socially responsible criteria. Departures from the criteria must be documented with the Deferred Compensation Advisory Committee and may result in deletion.

Real Estate Option is a mutual fund that primarily invests in real estate investment trusts (REITs) as well as corporations involved in real estate and land development.

Self-Directed Brokerage Account ("SDBA") Option will offer a wide array of stocks, bonds and mutual funds that can be accessed by individual Participants. Participants electing the SDBA will be required to acknowledge that they are sufficiently sophisticated and knowledgeable about investment matters that they are capable of making, managing and controlling their own investment choices. Investments in the SDBA are not subject to the due diligence of the core fund offerings.

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Benchmarks

Investment Option / Fund	Peer Group	Passive Benchmark
Money Market	Money Market Universe	90-day T-bills
Stable Value	Money Market Universe	90-day T-bills
Intermediate Term Bond	Intermediate Bond MF Universe	Barclays Capital U.S. Aggregate Bond Index
Treasury Inflation Protected Secs.	Inflation Protected Bond MF Universe	Barclays Capital U.S. TIPS Index
Foreign Bond	World Bond MF Universe	Citi World Government Bond Index
Balanced	Appropriate MF Universe	
Pre-Set Asset Allocation Funds (target date or risk-based)	Appropriate MF Universe	
Large Cap Index/Blend	Large Cap Core/Blend MF Universe	S&P 500 Index
Large Cap Growth	Large Growth MF Universe	S&P/Citi 500 Growth Index
Large Cap Value	Large Value MF Universe	S&P/Citi 500 Value Index
Mid Cap Blend	Mid Cap Core/Blend MF Universe	Russell Mid Cap Index
Mid Cap Growth	Mid Growth MF Universe	Russell Mid Cap Growth Index
Mid Cap Value	Mid Value MF Universe	Russell Mid Cap Value Index
Small Cap Blend	Small Cap Core/Blend MF Universe	Russell 2000 Index
Small Cap Growth	Small Growth MF Universe	Russell 2000 Growth Index
Small Cap Value	Small Value MF Universe	Russell 2000 Value Index
Foreign Large Cap	Non-US MF Universe / Foreign Large Blend MF Universe	MSCI EAFE
Foreign Small Cap	Foreign Small Cap MF Universe	MSCI EAFE Small Cap
Emerging Markets	Diversified Emerging Markets MF Universe	MSCI EM
Real Estate	Relevant Sector MF Universe	FTSE NAREIT All Equity REITs

WATCH LIST

POLICY:

If a fund or investment option fails to meet the standards of investment performance over a three or five year investment horizon, or if there are other concerns about the investment option, the Committee or designated subcommittee may take the following steps.

The fund or investment option may be placed on the Watch List. The Committee or designated subcommittee will attempt, but is not required, to make a decision to retain or remove the investment option during the following 12 months. The Committee may, in its discretion, terminate any fund or investment option at any time. Funds or investment options placed on the Watch List may be retained for criteria which includes, but is not limited to, the following:

- Investment performance above the average of its applicable peer group over a three or five year investment horizon
- Investment performance above the applicable passive benchmark over a three or five year investment horizon
- Sharpe ratio above the average Sharpe ratio for the applicable peer group or passive benchmark over a three or five year investment horizon.

On a semi-annual basis each fund on the Watch List will be reviewed and monitored.

Funds or investment options that do not satisfy the above criteria, or are not recommended for retention for other reasons, will be considered for replacement.