OPEB TRUST
Hedge Funds
Investment Policy Statement

Introduction

Hedge funds, also known as absolute return strategies, represent an investment in manager skill rather than a particular asset class. The widely accepted universe' of hedge fund investment strategies includes event-driven (e.g., merger arbitrage, distressed securities, special situations), relative value (e.g., convertible arbitrage, fixed-income arbitrage, market neutral equity), opportunistic/tactical (e.g., global macro and managed futures), long/short equity and long/short credit. These different strategies and "styles" tend to have low correlations to traditional, long-only equity and fixed-income strategies.

Unlike long-only managers whose returns are substantially explained by capital market movements, hedge fund managers can achieve returns substantially independent of normal market cycles. With their highly discretionary use of risk capital, hedge funds seek to generate profits regardless of conditions in the equity or fixed-income markets. To control risk or enhance return, hedge funds will often use short-selling, derivatives, leverage, and, in certain cases, illiquid securities. While hedge fund strategies often seek to mitigate the impact of general market's directional movements, hedge fund returns are still heavily influenced by market-related activity, such as trading volume, market volatility, credit spread levels, mergers & acquisitions, bankruptcy, IPOs and other corporate issuance.

In addition to the effectiveness of a particular investment strategy, hedge fund returns are dependent upon exceptional manager skill. To attract such talent, it is appropriately compensated. To that end, performance-based fees offering typically 15% to 20% of net profits (above “high water”), plus 1% to 2% annual management fees, generously reward successful hedge fund managers while serving to align such managers with vested interests similar to their investors. Helping to further reduce the agency risks found in most long-only manager relationships, hedge fund managers typically invest, and are usually expected to invest, a significant portion of their personal net worth alongside their investors. Nevertheless, incentive fees on upside performance can, at the margin, adversely motivate hedge fund managers to consider riskier opportunities, thus warranting careful ongoing review of investments in funds of such managers.

The due diligence process of evaluating on individual hedge funds is particularly challenging and requires significant experience and knowledge of this portion of the investment management universe. As such, it poses certain challenges to a potential investor with limited resources. Therefore, to invest in hedge funds without the internal resources necessary to evaluate, hire, and monitor hedge funds individually, the Retiree Benefits Trust (Trust) of the City of Baltimore Trust (the “Trust”) recognizes the need to delegate this fiduciary responsibility. Accordingly, the Board of Trustees of the Trust ("the Board") will select, with assistance of its investment consultant, an investment adviser ("Investment Manager") who is qualified to properly assemble and manage a diversified portfolio of hedge fund investments (or "hedge fund of funds"). The Board's fiduciary responsibility will be to establish the scope and guidelines for a hedge fund program, properly select one or more Investment Managers consistent with that program, and appropriately evaluate and review such manager(s) vis-a-vis their stated investment objective(s) and peer group of managers with similar mandates.

Investment Objective

The Trust's aggregate hedge fund program seeks to achieve consistent positive real returns and to maximize long-term total return within prudent levels of risk through a well-diversified portfolio of hedge fund strategies that, in aggregate, do not materially rely upon the direction of the equity or fixed-income markets. This program's value-added return will be primarily derived from manager selection and, to a lesser degree, strategy allocation. However, for purposes of risk diversification, the Investment Manager is not expected to create concentrated exposures to individual partnerships or investment strategies, as defined below under Risk Management.

Performance Objectives

Evaluation of quarterly performance is necessary to assess the program's progress toward its long-term investment goals. It is understood that there will likely be periods during which performance deviates from long-term return objectives. During such times, greater emphasis shall be placed on performance comparisons with fund-of-fund managers that employ similar styles or strategic allocations.

The performance objectives for each individual Investment Manager are as follows:

- To achieve a minimum of 5.0% annualized excess return over 3-month Treasury bills based upon rolling 5-year periods, net of all fees.
- •To achieve an above-median ranking in a comparable style group of hedge fund-of-funds (e.g., Wilshire Hedge Fund of Funds) based upon rolling 3-year periods, thereby demonstrating superior returns over longer time frames.
- To achieve the above return objective with an expected standard deviation of such returns of less than 10% per annum.
- To achieve the above return objective with an expected Beta to the S&P 500 index of less than 0.3 over rolling 5-year periods.

Attaining these objectives does not guarantee continued investment by the Trust nor does failure to achieve these guidelines mandate termination of the investment.

Commingled Accounts

In the case of a group trust, mutual fund, or other commingled account, the Board understands that strict adherence to the investment guidelines set forth within this section is impractical. Accordingly, the Board waives such strict adherence, and the commingled account's investment objectives, policies and restrictions, as set forth in its current prospectus and statement of additional information (as amended from time to time), shall govern the investment of the Trust's assets. The commingled account shall also exercise prudent care in managing the portfolio.

Investments in commingled accounts by investment managers shall be subject to the following restrictions:

1. The investment manager of the commingled account shall be a Registered Investment Advisor under the Investment Advisors Act of 1940.
2. All persons or entities responsible for the management, control, custody, maintenance and investment of the assets of the commingled account shall be legally bound to function in a fiduciary capacity in their relationship to the management, control, custody, maintenance and investment of the assets of such commingled account.
3. Funds and assets of the commingled account shall not be subject to claims or attachments made by any creditors of, or governmental regulatory agencies having authority over, all persons or entities responsible for the management, control, custody, maintenance and investment of the commingled account, except to the extent that any such claims or attachments directly and materially relates to the group trust or its operations.
4. Fees paid to the manager of the commingled account shall be part of, and not in addition to, fees paid by commingled account participants to their respective investment manager. Commingled account participants shall not incur fees or expenses for participating in the group trust in excess of fees paid to investment managers as set forth in the governing documents of such commingled account.

If a separate account is used in lieu of a commingled account, the selected Investment Manager will be granted full discretion to invest the Trust's hedge fund allocation in a manner consistent with the objectives and guidelines set forth in this document. In such case, the Investment Manager is required to submit a written statement to the Board acknowledging its role as a fiduciary, and any limitations thereof.

Investment Manager Hiring Guidelines

When conducting a search for an Investment Manager, the Board shall apply the following guidelines for qualifying an Investment Manager:

- The Investment Manager of the fund-of-funds vehicle shall be a bank, insurance company, or a registered investment adviser under the Investment Advisers Act of 1940.
- The Investment Manager shall not allocate any monies within the Trust's hedge fund-of-funds to any affiliated hedge funds, unless otherwise disclosed and specifically allowed.
- In the case of a commingled investment, the Board prefers that its investment shall not represent more than 10% of the commingled vehicle's total market value, except if the vehicle has substantially the same managers and strategic allocations as another vehicle of the Investment Manager, in which case the investment shall not exceed 10% of the total market value of the combined vehicles. The Board also prefers that no other investment in the commingled vehicle by an investor, besides those affiliated with the Investment Manager, represent more than 10% of assets in such commingled vehicle(s).

Risk Management

While specific investment guidelines for commingled fund-of-fund vehicles are determined by the Investment Manager's legal documentation for each fund offering, the Board shall apply the following measures of diversification and risk management for evaluating and reviewing a hedge fund-of-fund program based on a [broadly diversified] mandate involving one or more Investment Managers:

- *Strategy Risk:* To be broadly diversified by strategic allocations, the Trust's hedge fund program shall contain exposures to the five broad investment categories of hedge funds: relative value, event driven, long/short equity, long/short credit and opportunistic/tactical strategies. The targeted maximum exposure to any one underlying hedge fund strategy (except for long-short equity), (e.g., convertible arbitrage, market neutral equity, fixed-income arbitrage, merger arbitrage, distressed securities, special situations, global macro, and managed futures) shall be 40% of the Trust's hedge fund assets, unless otherwise specifically exempted by the Board. Because of the highly uncorrelated nature of individual long-short equity managers to each other, the targeted maximum exposure to long-short equity managers shall be 60%. The above targeted exposures will be based on the combined allocations to hedge fund-of-fund portfolios and individual hedge fund portfolios, if any.
- *Economic Sector Risk:* To be broadly diversified by economic sector allocations[2], the maximum allocation to any one sector-specific strategy within the long-short equity strategy shall be 40% of assets. Maximum allocation to non-U.S. equity strategies within the long-short equity strategy shall be 40% of fund assets.

- *Manager Risk:* To be broadly diversified by manager allocations, the Trust's aggregate hedge fund program shall contain exposures to a minimum of 20 individual hedge funds, with the maximum exposure to any one hedge fund, or group of affiliated hedge funds, limited to 10% of the Trust's aggregate hedge fund program, unless otherwise specifically exempted by the Board. The Board may select a regional specific or strategy specific hedge fund of funds that may have under 20 individual hedge funds. It is also preferable for the underlying hedge fund manager to invest a portion of their assets in their funds.

- *Leverage Risk:* While financial leverage (i.e., assets in excess of equity capital) is useful for enhancing returns, the underlying hedge funds of the Trust's fund-of-fund portfolio shall use leverage in a prudent manner that, when aggregated, is consistent with leverage applied in other similar hedge fund of-fund programs (i.e., programs broadly diversified across both directional and non-directional strategies). Financial leverage at the fund-of-fund level is only acceptable for funding purposes in advance of anticipated contributions or redemptions.

- *Liquidity Risk:* While investments in illiquid securities, or hedge funds with long lock-up periods, are often key to enhancing returns, it is preferable that a majority of the underlying funds provide quarterly or better liquidity. Notwithstanding the stated redemption schedule of the Investment Manager and its underlying managers, the Board recognizes that such timetables for liquidity may be suspended by the Investment Manager under certain circumstances, such as periods of unusual financial stress within the markets or within underlying hedge funds.
- *Derivative Risk:* Unless otherwise approved by the Board, the Investment Manager may not elect to engage in derivatives transactions to offset, or hedge, unintended market exposures in underlying funds.

[2] As defined under the Global Industry Classification System (GICS) provided by S&P and MSCI.

Reporting Requirements

Each Investment Manager should note that the Trust operates on a fiscal year basis, from July 1st through June 30th; therefore, all performance reports should be prepared on a fiscal year basis. The Board requires continual awareness of the Trust's activity and position, both absolute and relative. To accomplish this, the following reports should be sent to the Board:

A. Quarterly Report

1. The Investment Manager will provide to the Board quarterly written reports which present the following information:

   - Calculation of estimated net asset value on a monthly basis, with a summary of discrepancies, if any, with the Fund Sponsor's custodian bank outstanding more than 90 days.
   - Performance results.
   - Listing of strategic allocations (e.g., convertible arbitrage, market neutral equity, fixed-income arbitrage, multi-strategy relative value, distressed, merger arbitrage, multi-strategy event-driven, long-short equity, global macro, managed futures) as a percent of the Investment Manager's total fund assets as of quarter end.
   - Disclosure of any positions of financial or market leverage, such as cash borrowings or derivatives exposure, created directly by the Investment Manager with a notional amount greater than 10% of total fund assets.
   - Identification of any underlying managers with a market value greater than 3% of total fund assets.
   - Notice of changes in organizational structure, ownership, key personnel, and investment strategy of the firm. Material changes shall be reported in a timely manner to both the Executive Director and the investment consultant by at least two means of communication (e.g., phone call, email, fax, and/or letter).
   - Dealings with minority and woman-owned businesses for separate accounts.
   - Clients gained or lost for the strategy invested in by the Trust.

   On an annual basis, the reports should also include:

   - Annual filing of Form ADV with the Securities and Exchange Commission.
   - Annual audited financial statements related to the Fund Sponsor's investment.
   - Firm composition specifying majority, minority, and women personnel by management category.

2. Brokerage Report

   In order to assist the Board in tracking compliance with their brokerage policies, Investment Managers are required to provide a quarterly summary report of the brokerage activity for the Trust showing a breakdown by firm of amounts and percentages of brokerage commissions, commissions and discounts through recapture brokers and through City of Baltimore majority, minority-owned, and woman-owned brokerage firms. These reports should also reflect fiscal year-to-date amounts and percentages.

3. Report of Firm Officers and Directors Serving as Directors of Publicly Traded Companies

For the purpose of full disclosure for any perceived or potential conflict of interest, Investment Managers are required to report quarterly information regarding the firm's policy, firm officers and directors serving as directors of publicly traded companies, and Trust and firm investments in those companies. The report must set forth:

a. The Firm's Policy

The Investment Management firm's written policy governing the ability of firm officers and directors to serve as directors of publicly traded companies; OR, a statement that no written policy exists. Any changes to the policy are to be noted quarterly.

b. Information about Directors

For firm officers and directors serving as directors:

- The date the firm officer or director became a director of the publicly traded company;
- The name of the officer or director; and
- The name of the publicly traded company;
- OR, a statement that no firm officer or director serves as a director of a publicly traded company.

c. Information on Trust Investments

Information regarding Trust investments made by the Investment Manager in hedge funds of which a firm officer or director serves as a director, to include for any fund shares purchased or sold:

- Transaction dates
- Cost basis
- Sales proceeds
- Gains and losses on the sale of shares
- Market value of shares held at the end of each quarter;
- OR, a statement indicating that the Trust is not invested in any of the hedge funds of which a firm officer or director serves as a director.

d. Information on Firm-Wide Investments

Information regarding investments made firm-wide by the Investment Management firm in hedge funds of which a firm officer or director serves as a director, to include as of the end of each quarter:

1. Cost basis
2. Market value
3. The Investment Management firm's percentage of ownership in the hedge fund;
4. OR, a statement indicating that the Investment Management firm is not invested

in any of the hedge funds of which a firm officer or director serves as a director.

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A. Report Submission

Written quarterly reports are to be submitted within 45 days of the end of each quarter (September 30th, December 31st, March 31st, and June 30th) and mailed directly to the members of the Board, the Trust's Executive Director, Deputy Executive Director , and-Accounting Manager. The Trust will supply each Investment Manager with a current mailing list. When necessary, a revised list will be sent to each Investment Manager.

B. Annual Most-Favored Nation Fee Compliance Report

On July 1 of each year, the Investment Manager shall certify, by letter of its legal counselor compliance officer, compliance with the most-favored nation clause in its Investment Management Agreement.

C. Performance Review Presentation before the Board of Trustees

It is the Board's intention to formally review Investment Manager performance on a regular basis. Investment Managers are expected to personally appear annually, or at the Board's request, at regular monthly or special meetings of the Board to discuss performance results, economic outlook, investment strategy, organizational changes, and other pertinent matters. The written and oral presentations at these meetings should include the following:

- *Performance for Past Period:* Standard time periods for each report should include at least: Last Quarter, Year to Date, Latest 12 Months, 3 Years and Since Inception. Returns should be annualized for periods over one year and calculated on a time-weighted basis for the total portfolio. All returns should be net of all management and incentive fees.
- *Rationale for Performance Results:* Discussion of the rationale for performance results, relating specifically to strategic and manager allocations during the current review period.
- *Specific Near-Term Strategy:* Discussion of the Investment Manager's strategy for the portfolio over the near-term period.
- *Changes in the Investment Manager's Firm:* Discussion of any changes in the Investment Manager's firm including, but not limited to, organizational structure, ownership, key personnel, investment strategy and philosophy.
- *Changes in the Fund's Requirements:* Discussion of any changes in the Investment Manager's fund objectives or guidelines, particularly in relation to the Fund Sponsor's above stated objectives and guidelines.

In a month when an Investment Manager is scheduled to personally appear before the Board, the written quarterly reports are to be mailed directly to the members of the Board of Trustees, the Executive Director, Deputy Executive Director, and the Accounting Manager at least one week in advance of the appearance date. Ten (10) additional copies of the reports should also be mailed to the Executive Director one week prior to the appearance date. If the additional copies cannot be delivered in this manner, then the reports can be personally delivered on the appearance date. The additional copies are only required for review meetings with the Board and are not required any other time.

D. Telephone and Written Communication

Immediate telephone and written communication should be made by the Investment Manager to the Executive Director when information of an important nature, such as unusual market activity (oil embargo, monetary crisis, SEC Regulatory issues, etc.) may have a material impact on the Trust's assets.

Major changes in personnel and organizational structure should also be communicated in writing to the Executive Director.

AMENDMENTS

If at any time these objectives cannot be met, or these guidelines constrict performance, the Board should be notified in writing. The Investment Manager is encouraged to suggest changes to these guidelines at any time.

Accepted by:

____ _______________________
Name Date

____
Firm

APPENDIX – DEFINITIONS OF HEDGE FUND STRATEGIES

Relative Value

Within the relative value, or arbitrage, style of hedge funds, the three principal strategies as defined by Standard & Poor’s are:

Equity Market Neutral

Funds take both long and short positions in equities. Stock positions are usually diversified, so that no one position has a disproportionate effect on the portfolio. Related short positions hedge out much of the systematic risk in the long positions on either a dollar-or beta-adjusted basis so that the overall portfolio has a limited exposure to market moves.

Stocks are selected for inclusion in market neutral equity portfolios according to fundamental company specific factors, factor characteristics and the expectation of future returns to the factors, and statistical modeling of short-term anomalies created by supply and demand factors for individual stocks.

Specialties within this strategy are:

- Statistical Arbitrage: Anomaly-driven, quantitative, double-alpha strategy. Statistical Arbitrage usually engages in very short-term trading and usually focuses on residual mean reversion.
- Quantitative: A quantitative application of fundamental analysis, using Barra factor and other models, that are often momentum, earnings, or valuation based. Quantitative Equity Market Neutral is a longer term strategy [than Statistical Arbitrage].
- Fundamental: A bottom-up, fundamentally driven stock picking approach with a longer time horizon.

Fixed Income Arbitrage

Fixed Income Arbitrage funds exploit the relative values of fixed income instruments. The manager takes positions in government bonds and investment-grade corporate bonds, government agency securities and swap contracts, and futures and options on fixed income instruments. The manager generally constructs the portfolio on a market neutral basis and often constrains it to be duration neutral within a given country (often developed countries).

A distinct sub-specialty within Fixed Income Arbitrage is U.S. Mortgage Arbitrage, where the manager takes positions in mortgage-backed securities such as residential pass-through securities and derivatives, and commercial mortgage securities. The manager attempts to neutralize the impact of interest rate changes and prepayment behavior of borrowers by combining long and short positions in mortgage securities with different characteristics and other hedging positions such as shorts in U.S. Treasuries and interest rate options and swaps.

Convertible Arbitrage

Convertible bonds range from investment-grade credits to busted convertibles, and a fund may concentrate on one or more of the high-delta, middle-delta, and low-delta convertible strategies. Convertible Arbitrage funds attempt to exploit the mispricing in convertible securities. As the mispricing in convertible securities is typically small, this strategy will usually employ leverage. A convertible bond's valuation is dependent on the stock price and volatility of the underlying share, the credit rating of the issuer, the maturity and coupon of the bond, the expected future dividends of the underlying share, and the interest rate. A convertible manager takes an exposure to the volatility and/or the credit risk of the bond, hedging out the other factors. The stock

exposure is typically hedged out with a short position in the underlying company shares. The strategy is thus typically market neutral.

Specialties within this strategy are by region and type of strategy:

- Geographic: Global, U.S., Japan, and Europe.
- Delta Spectrum:
- High-delta: deep in-the money convertibles (a synthetic put strategy);
- Middle-delta: optionality/volatility exposure;
- Low-delta: busted converts (high yield).

Event-Driven Within the event-driven style of hedge funds, the three principal strategies as defined by Standard & Poor's are:

Merger Arbitrage

The Merger Arbitrage strategy involves taking positions in companies that are either currently or likely to be engaged in corporate mergers and acquisitions. Merger Arbitrage funds typically buy shares in the target and sell an appropriate quantity of shares in the acquirer in a merger deal. In a completed deal they will typically have an equal and opposite position in the acquirer, and will have earned a spread in the meantime. Factors that affect returns include the extent of the spread that can be earned through this transaction, the likelihood of a deal coming to fruition (it may break for regulatory, financial, or company-specific reasons), and the likely date of completion of the deal. Variations occur when the acquirer is bidding for the target with cash, or when the ratio of shares of the acquirer to be offered is dependent on the price of the shares.

Distressed

Distressed security funds generally invest in securities of financially troubled companies (companies involved in bankruptcies, exchange offers, workouts, financial reorganizations, and other special credit event-related situations). These managers may identify distressed securities in general or focus on one particular segment of the market (e.g., senior secured debt). Investments may be accumulated with a view to an exit via the secondary market, or with the expectation that the company will be recapitalized, restructured, or liquidated, where the fund manager may either seek to be actively or passively involved in the process. Managers may receive equity after the restructuring of a distressed company.

High-yield funds price more easily and have more long/short activity; thus they have reasonable transparency. Bankruptcies, which are not necessarily correlated with other events in the market, form a major portion of this strategy class. Long-only funds seek capital gains by holding long-term stakes in bankrupt or financially distressed (or stressed) firms, while Long/Short funds take positions either within the capital structure of a firm or long and short positions in the debt of different companies, seeking to both add value and hedge out some market/systematic risk.

Special Situations

Special Situations encompasses funds that seek profit opportunities from a broad range of corporate events. Managers are either generalists, who engage in trading keyed to corporate events such as a merger, distressed finances or share prices, and changes to an index, or

specialists who concentrate on a specific niche they can exploit. Value-oriented funds invest in undervalued obligations including bank debt, high-yield bonds, trade claims, and equity securities created by discrete and often extraordinary events. Niche strategies include Capital Structure Arbitrage (which includes investing long and short in different parts of the capital structure of the same firm) or other relative-value trades, such as trading between ADRs and local shares or voting versus non-voting shares, as well as strategies involving trading a holding company versus positions in its listed subsidiaries (a "stub" trade). It also includes Closed End Fund Arbitrage, which involves the purchase and hedging of closed-end funds that may be trading at a significant difference from their net asset values.

Directional/Tactical

Within the directional, tactical or opportunistic style of hedge funds, the three principal strategies as defined by Standard & Poor's are:

Long/Short Equity

Long/Short Equity funds take long and short stock positions. The manager may attempt to profit from both long and short stock positions independently, or profit from the relative outperformance of long positions against short positions. The stock picking and portfolio construction process is usually based on bottom-up fundamental stock analysis, but may also include top-down macro-based views, market trends, and sentiment factors. Long/Short Equity managers specialize by region (e.g., global, U.S., Europe, or Japan) or by sector.

Managed Futures

Managed Futures funds take long and short positions in liquid financial futures such as currencies, interest rates, stock market indices, and commodities. Managed Futures programs typically base their investment decisions on strict quantitative methods, notably, trend-following models; other programs are more discretionary and based on fundamentals of the underlying commodity.

Global Macro Macro funds take long and short positions in currencies, bonds, equities, and commodities. The manager tries to exploit perceived divergences between and within these various asset classes. The investment decisions are based on a manager's top-down or macro views of the world, economy, government policy, interest rates, inflation, market dynamics, and sentiment. The manager may also base investment decisions on relative valuations of financial instruments within or between asset classes.