



INVESTMENT POLICY STATEMENT

Bhutan Health Trust Fund

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1. Introduction

Bhutan Health Trust Fund (BHTF) was formally established in 2000 under a Royal Charter. The primary aim of the BHTF is to promote the quality of life of the people of Bhutan through primary health care services. The BHTF was established with the purpose of providing a self-sustaining financing facility for the primary health care programs including an uninterrupted supply of critical vaccines, essential drugs, needles, syringes, cold chain equipment and other related drugs or equipment.

BHTF was a department under the Ministry of Health (MoH) after its inception in 1998. BHTF got delinked from the Royal Civil Service Commission and became an autonomous agency on 1st September 2018.

A component of the health care requirements is priced in foreign currency and the balance in either Indian Rupees or Ngultrum. To reflect its obligation to preserve the purchasing power of BHTF portfolio in foreign currency, Asian Development Bank (ADB) has agreed to provide seed funding in United States Dollar to the BHTF under a Technical Assistance program. In addition, some health care supplies are also priced in domestic currency. It is expected that these expenses will be supported by the portion of BHTF funds denominated in domestic currency. Fund raising for domestic currency is outlined in the BHTF's Fund Mobilization Strategy.

The purpose of this Investment Policy Statement is to establish guidelines for the BHTF's investment portfolio (the "Portfolio"). The statement also incorporates accountability standards that will be used for monitoring the progress of the Portfolio's investment program and for evaluating the contributions of the manager(s) hired on behalf of the BHTF and its beneficiaries.

This Investment Policy Statement sets for the investment objectives, distribution policies, and investment guidelines that govern the activities of the Asset Management Committee (AMC) and any other parties to whom the AMC has delegated investment management responsibility for Portfolio assets in line with Article VIII of the Royal Charter of 2000.

2. Approach of the Investment Policy Statement

The investment policies for the BHTF contained herein have been formulated in consistent with the BHTF's anticipated financial needs and in consideration of the BHTF's tolerance for assuming investment and financial risk, as reflected in the majority opinion of the AMC.

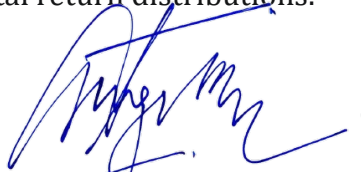
The Investment policy statement takes into consideration the short-term and long-term financial goals of the BHTF and intend to provide sufficient investment flexibility in the face of changes in capital market conditions and in the financial circumstances of the BHTF in line with Article III of the Royal Charter of 2000.

3. Investment Objective

The Portfolio is to be invested with the long-term objective of preserving the real purchasing power of assets while in the short-term providing a relatively predictable and growing stream of annual distributions in support of primary health care in Bhutan.

4. Spending Policy

- a. For the purpose of making distributions, the BHTF shall make use of total-return-based spending policy, meaning that it will fund distributions from net investment income, and net realised capital gains. 70% of the net investment income can be utilized for financing primary health care in Bhutan, 20% is to be ploughed back for capital growth and 10% to meet the operational costs of the Secretariat.
- b. The distribution of BHTF assets will be permitted to the extent that such distributions do not exceed a level that would erode BHTF's real assets over time. The AMC will seek to reduce the variability of the annual BHTF distributions by factoring healthcare requirements and Portfolio asset values into its current spending decisions. The AMC will review its spending assumptions annually for the purpose of deciding whether any changes therein necessitate amending BHTF's spending policy, its target asset allocation, or both.
- c. Periodic cash flow, either into or out of the Portfolio, will be used to better align the Portfolio to the target asset allocation outlined in Section 4.a.
- d. Cash flow from the international portfolio will be retained in foreign currency as outlined in Section 4.a.iii. Domestic portfolio's principal and total return can be used in lieu of international portfolio's realized total return distributions.



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5. Portfolio investment policies

a. Asset allocation policy

- i. The strategic allocation of Portfolio assets across broadly defined financial asset and sub-asset categories with varying degrees of risk, return and return correlation will be the most significant determinant of long-term investment returns and Portfolio asset value stability.
- ii. Actual returns and return volatility may vary from expectations and return objectives across short periods of time. While BHTF wishes to retain flexibility with respect to making periodic changes to the Portfolio's asset allocation, it expects to do so only in the event of material changes to BHTF, to the assumptions underlying BHTF spending policies and/or to the capital markets and asset classes in which the Portfolio invests.
- iii. The BHTF assets will be managed in two major components – 1) a Domestic Portfolio and 2) an International Portfolio. The motivation for this structure is that the funds from the Domestic Portfolio cannot be used for international investments due to the non-convertibility of the domestic currency to foreign currency. Net investment income, net realized capital gains, and proceeds from the sale of investments from the International Portfolio will be retained in foreign currency to grow the international component of BHTF to better match its foreign currency expenditure on healthcare.
- iv. The Domestic Portfolio will be invested in domestic assets denominated in domestic currency. The role of fixed income assets will be to generate steady returns and provide some protection against a prolonged decline in international portfolio. The investible instruments are fixed deposits, bonds, annuities of local issuers, stocks and mutual funds. BHTF may review the list of investible instruments at least annually

Strategic Asset Allocation of Domestic Portfolio

Asset Class	Target Allocation	Range
Equity	10%	5 - 15%
Fixed Income/Deposits	85%	80 - 100%
*Cash	5%	0 - 5%

*The cash balance can exceed the set limit for a period of 90 days during which period appropriate investment avenues will have to explored to adjust the exceeding limit.

- v. The International Portfolio will be measured in the currency of United States Dollar and managed as a balance portfolio composed of two major components: an equity portion and a fixed income portion. The expected role of the equity

investments will be to maximize the long-term real growth of Portfolio assets, while the role of fixed income investments will be to generate current income, provide for more stable periodic returns, and provide some protection against a prolonged decline in the market value of Portfolio equity investments.

- vi. Cash investments will, under normal circumstances, only be considered as temporary Portfolio holdings and will be used for the BHTF liquidity needs or to facilitate a planned program of dollar-cost averaging into investments in either or both equity and fixed income asset classes. The long-term strategic asset allocation guidelines determined by the BHTF to be the most appropriate, given the BHTF's long-term objectives and short-term constraints. Portfolio assets will, under normal circumstances, be allocated across broad asset and sub-asset classes in accordance with the following guidelines:

Strategic Asset Allocation of International Portfolio

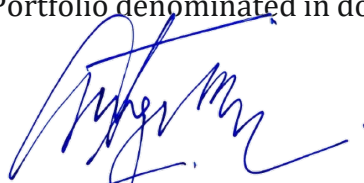
Asset Class	Sub-Asset Class	Target Allocation	Range
Equity		70%	65 - 75%
	US Equities	50%	45 - 55%
	Non-US Equities	10%	5 - 15%
	Global Healthcare	10%	5 - 15%
Fixed Income/ Deposits		30%	25 - 35%
	Investment grade	20%	15 - 25%
	Government	10%	5 - 15%
Alternative		5%	0 - 10%
	Gold	5%	0 - 10%
Cash		0%	0 - 5%

- vii. Alternative investments may be approved by the AMC on a case by case basis. Alternative investments may not exceed 10% of the entire portfolio and to the extent they are owned, will proportionately reduce the target allocations of the three primary asset classes listed above. Such an approval must be tabled at the next available Board meeting for informational purposes. Allowed Alternative Investments are listed in **Appendix 1**.

b. Diversification policy

Diversification across and within asset classes are the primary means by which the AMC expects the Portfolio to avoid undue risk of large losses over long time periods. To protect the Portfolio against unfavorable outcomes within an asset class due to the assumption of large risks, the Committee will take reasonable precautions to avoid excessive investment concentrations. Specifically, the following guidelines will be in place:

- i. In relation to the Domestic Portfolio denominated in domestic currency:



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- a) Except for fixed income investments explicitly guaranteed by the Royal Government of Bhutan, no single Issuer shall represent more than 20% of total Portfolio assets.
 - b) Single issuer limit of 20% can be exceeded for maximum of one issuer with the approval of the AMC. Such an approval must be tabled at the next available Board meeting for informational purposes.
 - c) Every position that continues to exceed Single issuer limit must be reviewed by the AMC on an annual basis. The analysis and approval recommendation must be provided to the Board.
- ii. In relation to the International Portfolio denominated in foreign currency:
 - a) With the exception of fixed income investments explicitly guaranteed by the United States government, no single issuer of fixed income securities shall represent more than 5% of the total Portfolio assets.
 - b) With the exception of passively managed investment vehicles seeking to match the returns on a broadly diversified market index, no single investment pool or investment company (mutual fund) shall comprise more than 20% of Total Portfolio assets.
 - c) With respect to fixed income investments, for individual bonds, the minimum average credit quality shall be investment grade (Standard & Poor's BBB or Moody's Baa or higher). In case of downgrade below investment grade after investment, a decision on divestment should be recommended by the AMC.

c. Rebalancing

It is expected that the Portfolio's actual asset allocation will vary from its target asset allocation as a result of the varying periodic returns earned on its investments in different asset and sub-asset classes. The Portfolio will be rebalanced to its target normal asset allocation under the following procedures:

- i. The investment manager will use incoming cash flow (contributions) or outgoing cash movements (disbursements) of the Portfolio to realign the current weightings closer to the target weightings for the Portfolio.
- ii. The investment manager will review the Portfolio semi-annually (June 30 and December 31) to determine the deviation from target weightings. During each semi-annual review, the following parameters will be applied:
 - a) If any asset class (equity or fixed income) within the portfolio is over or below its range of portfolio weights, the Portfolio will be rebalanced.
 - b) If any investment within the Portfolio has increased or decreased by greater than 20% of its target weighting, the fund will be rebalanced.
- iii. The investment manager may provide a rebalancing recommendation at any time.

d. Investment opportunities

The investment manager shall act within a reasonable period of time to evaluate the deviation from these ranges.

Unless expressly authorized by the AMC, the Portfolio and its investment managers are prohibited from:

- i. Purchasing securities on margin or executing short sales.
- ii. Pledging or hypothecating securities.
- iii. Purchasing or selling derivative securities for speculation or leverage.
- iv. Engaging in investment strategies that has the potential to amplify or distort the risk of loss beyond a level that is reasonably expected, given the objectives of their Portfolio.
- v. Investment in non-traditional, illiquid, and/or non-marketable securities including but not limited to private equity, hedge funds, venture capital, and real estate investments.



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6. Monitoring portfolio investments and performance

The AMC will monitor the Portfolio's investment performance against the Portfolio's stated Investment objectives. At a frequency to be decided by the AMC, it will formally assess the Portfolio and the performance of its underlying investments as follows:

- a.** The Portfolio's composite investment performance (net of fees) will be judged against the following standards:
 - i.** The Portfolio's absolute long-term real return objective:
 - a) Domestic Portfolio: 3% real rate of return based on Bhutan CPI
 - b) International Portfolio: 2% real rate of return based on U.S. CPI
 - ii.** A composite benchmark consisting of the following unmanaged market indexes:
 - a) U.S. Equity: Wilshire 5000 Total Market Index
 - b) Non-U.S. Equity: MSCI ACWI ex USA Index
 - c) Healthcare: S&P 500 Healthcare Index
- b.** The performance of professional investment managers hired on behalf of the Portfolio will be judged against the following standards:
 - i.** A market-based index appropriately selected or tailored to the manager's agreed-upon investment objective and the normal investment characteristics of the manager's portfolio.
- c.** In keeping with the Portfolio's overall long-term financial objective, the AMC will evaluate Portfolio and manager performance over a suitably long-term investment horizon, at a minimum on an annual basis.

Appendix 1: Allowed Alternative Investment Asset Classes

The following Alternative Investments Asset Classes are allowed:

- Gold – In the form of Mutual funds or Exchange Traded Funds (ETFs)
- Real Estates



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Appendix 2: Role of the Asset Management Committee

The Asset Management Committee (AMC) is acting in a fiduciary capacity with respect to the Portfolio, and is accountable to the Board of BHTF, for overseeing the investment of all assets owned by, or held in trust for, the Portfolio.

The AMC members shall consist of individuals capable of making sound, independent decisions, and of complementary skills. The AMC members should be appropriately qualified and experienced and should be committed to fulfilling their fiduciary duties. Minimum qualifications of the AMC members should include:

- A thorough understanding of the BHTF's obligations to the people of Bhutan as stated in the Royal Charter.
- The possession of core competencies that represents a balanced set of skills to enable the AMC to function as an effective collective body, and to execute its obligations successfully.

Successful management and oversight of the Portfolio requires that the AMC adhere to the following specific responsibilities:

- a. The AMC will review this Investment Policy Statement at least once per year. Review of the Investment Policy Statement may also be precipitated by significant changes in market conditions or the financial circumstances of the BHTF.
- b. Disclose potential conflicts of interest, at least annually. If the AMC members or staff members in decision making capacity are in possession of any information or relationship which would lead a reasonable person familiar with such matters to conclude that an investment, a commitment of an investment, or a decision to engage or terminate a contracted service provider, contradicts the fiduciary duties of the AMC member or staff member, disclosure of such information or relationship is mandatory. It is expected that the relevant party is recused from the decision-making process.
- c. Periodically review Portfolio returns and risk.
- d. Perform periodic review of the Portfolio's rebalancing activities and the compliance with policy Strategic Asset Allocation.
- e. Review the specific types and proportions of instruments being utilized in implementing the overall policy.
- f. Review and approve, prior to the execution of a contract, the hiring of each investment manager.
- g. Keep abreast of latest economic and market trends through research, discussion with investment managers and participation in investment forums where feasible.

Appendix 3: Asset Manager Selection and Monitoring Policy

The Asset Manager selection and monitoring policy provides a systematic, consistent, and rational framework for Manager retention and termination decisions, thereby minimizing sub-optimal actions that may adversely impact Portfolio returns. In addition, the Policy is intended to:

- Foster a long-term approach to Manager evaluations.
- Provide a logical and statistically valid framework to evaluate Manager skill.
- Establish clear client Manager communication by informing each Manager of the quantitative and qualitative standards by which they will be judged, and the near-term and long-term consequences of failing to meet these standards.
- Promote timely and appropriate responses to actual and potential performance issues.
- Provide flexibility to allow application across all asset classes, management styles and market environments.

This Policy shall apply to all the BHTF's Asset Managers, except where otherwise noted. The decision to retain or terminate should focus on both qualitative aspects of the Manager relationship as well as the quantitative assessments of past performance.

Manager Monitoring

1. Manager Meeting Frequency and Content

The AMC will have meetings with the Asset Manager at least once every 12 months either at the Manager's place of business or through a telephonic call or videoconferencing facility, whichever is practicable. Each meeting should include a review of the Manager's near-term and long-term performance, the Manager's current investment strategy and capital markets outlook, and any other pertinent issues related to the Manager's organization, personnel, or investment process. Each manager may make periodic presentations to the AMC, the frequency, content and timing of which shall be mutually agreed between the Manager and the AMC.

2. Qualitative Assessments

The qualitative aspects of each Manager relationship shall be monitored through oral and written contacts by the AMC with each Manager, and when appropriate through semi-annual evaluations. Qualitative assessments will focus on organizational and staff stability, adherence to investment philosophy and process, asset and client turnover, and quality of client service.



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A significant and potential adverse event related to, but not limited to, any of the following qualitative issues or events will generally cause either to place the Manager on the watchlist or to initiate a review, depending on the impact of the event or issue, in particular:

- A significant change in the Manager's ownership or structure
- The loss of one or several key personnel
- A significant loss of clients or assets under management
- A profound shift in the Manager's investment strategy
- A significant and persistent lack of responsiveness to client requests
- Chronic violation of the investment guidelines.

3. Quantitative Standards

Judgement as to whether a Manager has achieved the BHTF'S investment objectives, and whether a Manager will achieve the investment objectives in the future, ultimately rest with the AMC. Accordingly, the AMC reserves the right to determine the use of any absolute, relative, historic or perceived future investment performance metric in assessing manager performance and taking appropriate actions.

It is often very difficult to assess whether a Manager's over or under performance is due to randomness or true investment skill. Quantitative analysis should consider the variability of Manager's excess returns in addition to the absolute magnitude of the excess return. Over long periods skilled managers should produce positive excess returns more frequently than unskilled managers.

Courses of Action

Based on the qualitative and quantitative assessment of the Manager performance, the AMC could consider the following courses of action:

1. Do nothing and continue to monitor the situation
2. Place Manager on a watch list:

Being placed on the watch list communicates to the Manager the AMC's concern about a situation. A Manager will be placed on the watch list for a specified length of time, normally 12 months. AMC will discuss with the Manager the nature of the issue and steps needed to be taken to resolve the issue. A Manager will generally remain on the watch list until the specific time period expires, or until the issue is resolved.

3. Initiate a performance review

A performance review is a thorough, in-depth, due diligence effort, similar in scope to the Manager selection process. A review analyzes all facets of a Manager's organization, personnel and investment philosophy and process. The outcome of a review may result in a decision to retain or terminate the Manager. The review may consider the following aspects of the Manager's organization that may be important for the success of the Manager's investment program:

- Organization
 - Stable ownership structure
 - Experienced, dynamic leadership
 - Clearly delineated lines of authority and responsibility
 - Sound financial condition
 - Strong Compliance and internal controls
- Personnel:
 - Experienced and competent investment staff
 - Low turnover in key positions
 - Employees highly motivated to meet client objectives
 - Sufficient backup and on-going training
- Investment Process and Philosophy
 - Well-articulated philosophy
 - Investment process is systematic, focused and consistent
 - Investment process has been applied in different market conditions
 - High quality research base
 - Investment process can be benchmarked
 - Strong trading capabilities
 - High quality deal flow and investment opportunities
 - Cost structure in relation to the returns generated.

4. Terminate the Manager's contract

Appendix 4: Fund Investment Authority Matrix

Sl. No.	Amount in Nu	Remarks
1.	100 to 500 million	The BHTF Secretariat with approval from the Director, can invest only in Fixed Deposit and appraise to AMC for endorsement.
2.	501 to 1,000 million	AMC can direct the BHTF secretariat to invest in Fixed deposit, equity, or gold form and appraise to Board for endorsement.
3.	1001 million and above	Board has full decision authority to advice the BHTF secretariat to invest in most appropriate scheme with recommendation from AMC.



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