

FLORIDA RETIREMENT SYSTEM TOTAL FUND INVESTMENT PLAN

I. DEFINITIONS

Absolute Real Target Rate of Return - The total rate of return by which the FRS Portfolio must grow, in excess of inflation, in order to achieve the long-run investment objective.

Asset Class - An Asset Class is an aggregation of one or more Portfolios with the same principal Asset Type. For example, all of the portfolios whose principal asset type was stocks would be aggregated together as the Stock Asset Class. As such, it would contain primarily—but not exclusively—the principal asset type.

Asset Type - An asset type is a category of investment instrument such as common stock or bond.

Portfolio - A portfolio is the basic organization unit of the FRS Fund. Funds are managed within portfolios. A portfolio will contain one principal asset type (common stocks, for example), but may contain small amounts of other asset types as well. The discretion for this mix of asset types is set out in guidelines for each portfolio.

II. OVERVIEW OF THE FRS AND SBA

The State Board of Administration (Board) provides investment management of assets contributed and held on behalf of the Florida Retirement System (FRS). The investment of retirement assets is one aspect of the activity involved in the administration of the total Florida Retirement System. The Division of Retirement (DOR) the administrative agency for the FRS, provides full accounting and administration of benefits and contributions, commissions actuarial studies, and proposes rules and regulations for the administration of the FRS. The State Legislature has the responsibility of setting contribution and benefit levels, and providing the statutory guidance for the administration of the FRS.

III. THE BOARD

The State Board of Administration has the authority and responsibility for the investment of FRS assets. The Board consists of the Governor, as Chairman, the Chief Financial Officer, as Treasurer, and the Attorney General, as Secretary. The Board has statutory responsibility for the investment of FRS assets, subject to limitations on investments as outlined in Section 215.47, Florida Statutes.

The Board shall discharge its fiduciary duties in accordance with the Florida statutory fiduciary standards of care as contained in sections 215.44(2)(a) and 215.47(9), Florida Statutes.

The Board delegates to the Executive Director the administrative and investment authority, within the statutory limitations and rules, to manage the investment of FRS assets. A six-member Investment Advisory Council (IAC) is appointed by the Board. The IAC meets quarterly, and is charged with the review and study of general portfolio objectives, policies and strategies, including a review of economic conditions.

The mission of the State Board of Administration is to provide quality professional trust services for the State of Florida through prudent debt administration and investment management of assets entrusted to the Board.

IV. THE EXECUTIVE DIRECTOR

The Executive Director is charged with the responsibility for managing and directing administrative, personnel, budgeting, and investment functions, including the strategic and tactical allocation of investment assets.

The Executive Director is charged with developing specific individual investment portfolio objectives and policy guidelines, and providing the Board with monthly and quarterly reports of investment activities.

The Executive Director has investment responsibility for maintaining diversified portfolios, and maximizing returns with respect to the broad diversified market standards of individual asset classes, consistent with appropriate risk constraints.

The Executive Director is responsible for evaluating the appropriateness of the goals and objectives in this Plan in light of actuarial studies and recommending changes to the Board when appropriate.

V. INVESTMENT OBJECTIVES

The investment objective of the Board is to provide investment returns sufficient for the plan to be maintained in a manner that ensures the timely payment of promised benefits to current and future participants and keeps the plan cost at a reasonable level. To achieve this, a long-term real return of 4.0% per annum (compounded and net of investment expenses) should be attained. As a secondary consideration, the volatility of annual returns should be reasonably controlled to avoid excessive volatility in short-term plan cost levels.

The Board's principle means for achieving this goal is through investment directives to the Executive Director. The main object of these investment directives is the Asset Class. The Board directs the Executive Director to manage the Asset Classes in ways that, in the Board's opinion, will maximize the likelihood of achieving the Board's investment objective. The Board establishes Asset Classes, sets permissible shares of the total portfolio's value for each and establishes performance benchmarks for them. In addition, it establishes a performance benchmark for the total portfolio.

VI. TARGET PORTFOLIO AND ASSET ALLOCATION RANGES

The Board's investment objective is an absolute one: achieve a specific rate of return, the absolute real target rate of return. In order to achieve it, the Board sets a relative objective for the Executive Director: achieve or exceed the return on a performance benchmark known as the Target Portfolio over time. The Target Portfolio is a portfolio composed of a specific mix of the authorized asset classes. The return on this portfolio is a weighted-average of the returns to passive benchmarks for each of the asset classes. The expectation is that this return will equal or exceed the actuarial rate of return long-term and will thus assure achievement of the Board's investment objective.

This relative return objective is developed in a risk management framework. Risk from the perspective of the Board is failing to earn the absolute real target rate of return over long periods of time, and the asset mix is developed to minimize this risk. In selecting the Target Portfolio the Board considers information from actuarial valuation reviews and asset/liability studies of the FRS, as well as historical asset class risk and return characteristics. In addition, the timing of cash demands on the portfolio to honor benefit payment liabilities are an important input. Periods of positive cash flow into the fund from net contributions and investment income receipts permit higher exposures to Equities, while cash demands on the portfolio will dictate lower Equity exposures. Potential asset mixes are thus evaluated with respect to their expected return and volatility as well as risk.

The Target Portfolio defined in Tables 2 and 3 has a long-term expected compound annual real return that approximates the absolute real target rate of return. To achieve the absolute real target rate of return, market risk must be borne and Table 1 illustrates the potential range of real returns that could result over various investment horizons. Over a 30-year investment horizon there is a 10 percent probability that the Target Portfolio will experience a compound annual real return of 1.02 percent or less. Downside risk is considerably greater over shorter horizons, but the natural investment horizon for the Trust Fund is the very long-term.

Table 1: Expected Risk in Target Portfolio's Real Returns

Time Horizon	10 th Percentile Real Return	90 th Percentile Real Return
1 Year	-11.09%	21.50%
5 Years	-3.07%	11.46%
10 Years	-1.07%	9.20%
20 Years	0.37%	7.63%
30 Years	1.02%	6.95%

Although the Target Portfolio thus has an expected return and risk associated with it, it is important to note that this expected return is neither an explicit or implicit goal for the managers of the Florida Retirement System Trust Fund (FRSTF). These figures are used solely in developing directives for fund management that will raise the probability of success in achieving the absolute real target rate of return. The Executive Director is held responsible not for specifically achieving the absolute real target rate of return in each period, but rather for doing at least as well as the market using the Target Portfolio's mix of assets.

The Board establishes the Target Portfolio as being composed of the Asset Classes and Target Allocations identified in Table 2.

In pursuit of incremental investment returns, the Executive Director may vary the asset mix from the Target Allocation based on market conditions and the investment environment for the individual asset classes. The Executive Director shall adopt an asset allocation policy guideline, which specifies the process for making these tactical decisions. The guideline shall concentrate on the analysis of economic conditions, the absolute values of asset class investments and the relative values between asset classes. The Board establishes ranges for tactical allocations, as shown in Table 2:

Table 2: Authorized Asset Classes, Target Allocations and Ranges

Asset Class	Target	Range
Domestic Equities	48%	39-54%
Global Equities	4%	1-8%
Foreign Equities	14%	10-18%
Fixed Income	21%	11-31%
Real Estate	7%	3-10%
Alternative Investments	5%	1-8%
Cash Equivalents	1.0%	0-10%

For purposes of determining compliance with these Policy Ranges, an Asset Class is considered to be an aggregation of one or more portfolios with substantially the same principal asset type. An Asset Type is a category of investment instrument such as common stock or bond. For example, all of the portfolios whose principal asset type is bonds would be aggregated together as the Fixed Income Asset Class. As such it would contain primarily—but not exclusively—the principal asset type. As a standard management practice, portfolio managers are expected to meet their goals for all assets allocated to their portfolio.

It is expected that the FRS Portfolio will be managed in such a way that the actual allocation mix will remain within these ranges. Investment strategies or market conditions which result in an allocation position for any asset class outside of the enumerated ranges for a period exceeding thirty days shall be reported to the Board, together with a review of conditions causing the persistent deviation and a recommendation for subsequent investment action.

VII. PERFORMANCE MEASUREMENT

Asset class performance is measured in accordance with a broad market index appropriate to the asset class. The indices identified in Table 3 are used as the primary benchmarks for the authorized asset classes:

Table 3: Authorized Target Indices

Asset Class	Index
Domestic Equities	The Russell 3000.
Global Equities	A blend of the Russell 3000 weighted at 50% and the Morgan Stanley Capital International All Country World Free index, excluding the U.S., in dollar terms, weighted at 50%.
Foreign Equities	The Morgan Stanley Capital International All Country World Free index, excluding the U.S., in dollar terms.
Fixed Income	A total market weighted average of: a) the Lehman Brothers U.S. Aggregate and b) the market-value weighted composite of the BB-rated and B-rated sub indices of the Merrill Lynch High Yield Master Index, where total market weights represent the relative shares of the investment-grade and high yield markets.
Real Estate	The contemporaneous rate of consumer price inflation plus 450 basis points, per annum.
Alternative Investments	The domestic equities target index return plus a fixed premium return of 450 basis points per annum.
Cash Equivalents	Average 90-day Treasury Bill rate.

Internal measurement of asset allocation performance shall be made by comparing the actual asset allocation times the return for the appropriate indices to the target allocation times the index returns. For asset classes with floating target allocations, as defined in Table 4, the target allocation will be as stated in the table..

Performance measurement of the effectiveness of the implementation of the real estate asset class shall be relative to the target index in Table 3 and also relative to a secondary benchmark equal to the aggregation of individual real estate portfolio benchmarks, weighted by portfolio net asset values. Performance measurement of the effectiveness of the implementation of the alternative investments asset class shall be relative to the target index in Table 3 and also relative to a secondary benchmark equal to the aggregation of individual alternative investments portfolio benchmarks, weighted by portfolio net asset values. For both real estate and alternative investments, measurement shall be based on an internal rate of return methodology, in addition to time-weighted return comparisons, applied over significant periods of time.

Performance measurement of the effectiveness of the implementation of the alternative investments asset class shall be based on an internal rate of return methodology, applied over significant periods of time.

Table 4: Asset Classes with Floating Allocations

Asset Class with Floating Allocation	Basis of Tactical Measurement	Corresponding Asset Class	Basis of Tactical Measurement
Alternative Investments (AI)	Actual Share	Domestic Equities (DE)	DE target share plus AI target share minus AI actual share
Real Estate (RE)	Actual Share	Fixed Income (FI)	FI target share plus RE target share minus RE actual share

VIII. ASSET CLASS PORTFOLIO MANAGEMENT

General Portfolio Guidelines

The Executive Director is responsible for developing asset class and individual portfolio policies and guidelines which reflect the goals and objectives of this Investment Plan. In doing so, he is authorized to use all investment authority spelled out in Section 215.47, Florida Statutes, except as limited by this Plan or SBA Rules. The Executive Director shall develop guidelines for the selection and retention of portfolios, and shall manage all external contractual relationships in accordance with the fiduciary responsibilities of the Board.

All asset classes shall be invested to achieve or exceed the return on their respective benchmarks over a long period of time. The portfolios shall also be well diversified with respect to the benchmark.

IX. REPORTING

The Board directs the Executive Director to coordinate the preparation of quarterly reports of the investment performance of the FRS by the Board's independent performance evaluation consultant.

The following formal periodic reports to the Board shall be the responsibility of the Executive Director:

- An annual investment report of the SBA and the FRS.
- A monthly report on performance and investment actions taken.
- Special investment reports pursuant to Section 215.47(6), Florida Statutes.

X. IMPLEMENTATION SCHEDULE

This plan shall be effective June 1, 2003. However, the asset allocation target allocations listed in Table 2 shall be phased-in over a 12-month period beginning June 1, 2003 and ending May 31, 2004. Authorized ranges shall be adjusted accordingly. The changes to asset class targets for Real Estate and Alternative Investments shall become effective July 1, 2003.