

MICHIGAN PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM
INVESTMENT POLICY STATEMENT

August 2010

I. Introduction

The investment policies and objectives of the Michigan Public School Employees' Retirement System (MPERS) are intended to allow for sufficient flexibility in the management process to capture investment opportunities, yet provide parameters that will ensure prudence and care in the execution of the investment program. The State Treasurer, as sole fiduciary, in investing MPERS' assets shall act with the care, skill, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, in accordance with Public Act 314 of 1965, as amended (P.A. 314).

Definition of Terms

- A. Allocated Cash – Funds allocated to the investment managers. These funds are generated by income (interest, dividends) and monies earned as a result of the sales of a security. The investment managers' allocated cash is invested in cash equivalents as per the short-term investment policy and is readily available for investment by the investment manager.
- B. Cost – Book value or purchase price of the security.
- C. Market – Current price of the security if sold on the open market as of a given date.
- D. Policy – Definite course or method of action selected from among alternatives, in light of given conditions, to guide and determine present and future decisions.
- E. Strategic Asset Allocation – The long-range asset allocation of the plan designed to obtain a reasonable long-term total return, consistent with the degree of risk assumed, while emphasizing the preservation of long-term capital.
- F. Target Allocation – The percentage of MPERS portfolio (valued at market) to be allocated to the specific asset classes as outlined on pages five and six.
- G. Unallocated Cash – Funds generated by MPERS from contributions, less administrative expenses and benefit payments, invested in cash equivalents (but not managed by investment managers).

II. Assignment of Responsibilities

- A. The State Treasurer is the sole fiduciary and custodian of MPSERS' investments pursuant to State law. The State Treasurer, with input from the Bureau of Investments (BOI), internal and external investment managers, consultants, and other service providers, shall provide the following:
1. Establish a long-term fund target asset allocation, based on the analysis and advice of the Bureau of Investments.
 2. In conjunction with the Bureau of Investments, establish a process for evaluating and selecting external managers, where needed.
 3. In conjunction with the Bureau of Investments, establish a process for monitoring and evaluating the performance of internal and external managers, as well as the overall fund.
 4. The State Treasurer delegates investment authority to publically traded equities, fixed income, absolute, real return/opportunistic investments to the Bureau of Investments whereas approval of private real estate and private equity and venture capital will require approval from the State Treasurer
- B. The State Treasurer reports investment activity quarterly to the Investment Advisory Committee (Committee), which reviews the investments, goals, and objectives of the retirement funds and may submit recommendations regarding them to the State Treasurer. The Committee may also, by a majority vote, direct the State Treasurer to dispose of any holding, which in their judgment, is not suitable for the fund involved, and may by a unanimous vote, direct the State Treasurer to make specific investments.
- C. The Director of the Bureau of Investments serves as the Chief Investment Officer of the System. The Director will implement the goals as described in Section II, A (1, 2, 3) of this document as well as direct the investment operations of the MPSERS, including each major asset class, in compliance with statutory requirements and sound business practices.

III. General Objectives and Policies

The general objectives are intended to define the goals to be achieved through the management of MPSERS assets. General policies are intended to provide guidelines for the State Treasurer, as sole fiduciary, to follow in meeting the general objectives.

A. General Objectives

1. The overall objective of the MPSERS is to provide retirement, survivor, and disability benefits to its members through the investment of contributions and other MPSERS assets, utilizing policies designed to achieve a 100 percent funding level for the plan's liabilities over time.
2. The primary investment objective is to maximize the rate of return on the total investment portfolio, consistent with a high degree of prudence and sufficient diversity to eliminate inordinate risks and to meet the actuarial assumption for the investment rate of return, at a reasonable cost achieved by cultivating a motivated team of dedicated professionals.
3. The State Treasurer will seek to control the cost of funding the plan within prudent levels of risk through the investment of MPSERS assets.

B. General Policies:

1. All transactions undertaken on behalf of MPSERS will be for the sole benefit of plan participants.
2. All participants (including staff and external service providers) involved in the investment process shall act responsibly. All participants shall act with the care, skill, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, in accordance with Public Act 314 of 1965, as amended (P.A. 314), or as otherwise stated in the investment policy, or their contract.
3. All participants (including staff and external service providers) involved in the investment process shall refrain from personal business activity that could conflict with the proper execution and management of the investment program, or that could impair their ability to make impartial decisions. These parties are required to reveal all relationships that could create or appear to create a conflict of interest in their unbiased involvement in the investment process.
4. Investments shall be made without distinction between return generated from income as opposed to capital gains, and that diversification, need for liquidity, and the potential for gain and loss will be monitored on an on-going basis.

5. The allocation of assets among various asset classes shall be approved by the State Treasurer. The asset allocation policy shall be predicated on the following factors:
 - a. the historical performance of capital markets adjusted for the expectations of the future short and long-term capital market performance;
 - b. the correlation of returns and risk among the relevant asset classes;
 - c. the expectations of future economic conditions, including inflation and interest rate assumptions;
 - d. the projected liability stream of benefits and the costs of funding to both covered employees and employers;
 - e. the relationship between the current and projected assets of the plans and the projected actuarial liability stream.

This asset allocation policy will identify target allocations to the classes of assets MPSERS can utilize and the ranges within which each can fluctuate as a percent of the total portfolio. This policy is expected to provide diversification of assets in an effort to maximize the investment return to MPSERS consistent with prudent market and economic risk. All assets of MPSERS are to remain invested at all times in either cash equivalents or other asset classes as designated by this Policy.

6. Professional investment management firms, which are registered investment advisors or which are appropriately exempt from registration under the Investment Advisers Act of 1940 as may be amended, may be retained to assist in managing MPSERS assets. Investments shall be sufficiently diversified so as to minimize the risk of material losses. Each investment manager will function under a formal contract that delineates its responsibilities and appropriate performance expectations. A formal set of investment guidelines and administrative requirements for management of each portfolio is to be provided to each manager. The State Treasurer will review the investment performance of these managers against their stated objectives at least quarterly. Individual managers will be judged according to benchmarks, which reflect the objectives and characteristics of the strategic roles their portfolios are to fulfill. Other factors for consideration shall include, but not be limited to, fundamental changes in the manager's philosophy, changes in the manager's organizational structure, financial condition (including changes in total assets under management), personnel, changes in fee structure, and any regulatory or litigation brought against the manager. Investment managers may act at their own discretion provided their actions are in accordance with P.A. 314, the investment policy, and their contract.

7. The State Treasurer will allocate net pension fund contributions on an on-going basis in accordance with this Policy to balance the overall asset allocation against targets when deviations occur because of capital market fluctuations. Such allocations can be made even if contributions to managers or asset classes which have recently experienced poor performance are entailed. If such poor performance is the result of an occurrence other than expected market-related volatility, then a reassessment of that investment shall be undertaken.
8. The State Treasurer may utilize the services of an investment consultant for the purpose of performance review, asset allocation studies, risk budgeting, manager screening and selection, and topical studies. The comments and recommendations of the consultant will be considered by the State Treasurer, as sole fiduciary, in conjunction with other available information for the purpose of making an informed and prudent decision.
9. The State Treasurer will utilize the services of a master custodian bank that will be responsible for holding MPSERS assets, settling purchases and sales of securities; identifying and collecting income which becomes due and payable on assets held; and providing a management information/accounting system.
10. The State Treasurer may utilize the services of a securities lending provider to generate additional return for MPSERS at acceptable levels of risk. The program will be administered in accordance with the securities lending policy negotiated with the provider.
11. The MPSERS considers the active voting of proxies an integral part of the investment process. Proxy voting will occur in accordance with the Proxy Voting Policy incorporated by attachment.
12. Updated return projections and asset allocation will be developed at least every two years. The information for these reviews shall come from staff, outside consultants, and investment managers, as they may be retained.
13. It is the responsibility of the State Treasurer to administer the investments of MPSERS at reasonable industry standard cost, being careful to avoid sacrificing quality. These costs include, but are not limited to, management and custodial fees, consulting fees, transaction costs, and other administrative costs chargeable to MPSERS.
14. Any investment or any action pursuant to an investment for MPSERS which is not expressly permitted under this Policy is not allowed unless submitted in writing, and formally reviewed and approved by the State Treasurer.

15. The State Treasurer will operate the pension investment program in compliance with all applicable state, federal, and local laws and regulations concerning the investment of pension assets (USC Section 401 (a) (8), (9), (16), and (25) of the Internal Revenue Code; and under P.A. 314 as attached and may be hereafter amended).

IV. Asset Allocation Policy and Objectives

Based on the factors identified in the preceding General Policies, the State Treasurer has established strategic asset allocation targets and ranges on a market value basis as set forth below:

Ranges for each asset class are included in the asset allocation policy to provide the State Treasurer, as sole fiduciary, with flexibility to adjust to market fluctuations and portfolio changes.

A. The five-year strategic asset allocation targets are provided below:

	<u>Targets</u>	<u>Ranges</u>	<u>Statutory Limit*</u>
Domestic Equity	33%	20% - 50%	70%
International Equity ⁽¹⁾	16%	10% - 20%	
Absolute Return ⁽²⁾	6%	0% - 12%	20% (w/RRS)
Real Return/ Opportunistic ⁽²⁾	4%	0% - 8%	20% (w/ARS)
Private Equity ⁽³⁾	14%	10% - 20%	30%
Real Estate ⁽⁴⁾	9%	5% - 15%	
Core Fixed Income	16%	10% - 25%	
Cash/Short Term Fixed Income	2%	1% - 7%	
Total Assets	100%		

*Additional statutory limitations may apply pursuant to Public Act 314 of 1965.

(1) Investments in foreign securities shall not exceed 20%, pursuant to the statutory limitation of the PERS Investment Act, PA 314 of 1965 section 38.1140k.

(2) Absolute Return and Real Return/Opportunistic combined shall not exceed 20%, pursuant to the statutory limitation of the PERS Investment Act, PA 314 of 1965 section 38.1140d.

(3) Private Equity shall not exceed 30%, pursuant to the statutory limitation of the PERS Investment Act, PA 314 of 1965 section 38.1139a.

(4) No specific statutory constraints on Real Estate, pursuant to the exemption provided in the PERS Investment Act, PA 314 of 1965 section 38.1139

(5) Investments in derivative securities shall not exceed 15%, pursuant to the statutory limitation of the PERS Investment Act, PA 314 of 1965 section 38.1140j.

ASSETS CLASSES ARE DEFINED AS:

Equities	Investments representing ownership interest to include public, preferred stock, convertible to stock, options, futures or other derivatives on stocks or composites of stocks, units, participation or partnership shares which represent ownership interests in an underlying investment (excluding real property).
Private Equity	Investments representing ownership interest in partnerships and other vehicles including, but not limited to, venture capital, leveraged buyouts, mezzanine debt, and special situations. In addition, this asset class may include public stock as a result of distributions.
Real Estate	Investments representing ownership interest in partnerships, publicly traded securities, operating companies, or other vehicles that represent equity and/or mortgages in real estate including but not limited to, commercial, retail, hotel, industrial, residential, land, or other real estate related investments.
Fixed Income	Investments representing instruments with maturities greater than one year with obligated fixed or floating rates of interest to include public and private securities, mortgages, and investments in life insurance general accounts and guaranteed investment contracts, and options, futures or other derivatives on fixed income securities or fixed income components.
Cash/Short Term Fixed Income	Investments in fixed income securities with maturities of less than one year including, but not limited to, Treasury bills and notes, commercial paper, bankers acceptances, certificates of deposit, asset backed securities, Eurodollar securities and debentures, and mortgages with less than one year remaining to maturity.
Real Return/Oppportunistic	Investments representing ownership interest in either individual real return asset classes that provide an inflationary “hedge”, or portfolios that are managed strategically or tactically utilizing real return asset classes in isolation or in combination with traditional asset classes to achieve this goal. Opportunistic strategies may include tactical or strategic investments.

Absolute Return

Investments representing ownership interest in hedge funds managed to an overall risk tolerance. Diversification by fund and by strategy, such as long/short equities, arbitrage, and event driven strategies is important as is prudent leverage levels on a total portfolio. Absolute Return Strategies seek to produce return patterns over time that have a lower level of correlation with equities and other traditional asset classes.

THE STRATEGIC ROLE OF EACH ASSET CLASS AND SUBCLASS IS DEFINED AS FOLLOWS:

Domestic Equity (may include, but are not limited to the following)

Index/Passive – Index/Passive equity management attempts to replicate performance and characteristics of the applicable index and may be implemented through direct stock holdings, mutual funds, commingled funds or the use of swaps or other derivative instruments. Active management attempts to add value over the benchmark through country allocation, stock selection, etc.

Long-Short (130/30) – Diversified portfolio of stocks utilizing both long and short positions. The strategy has a limited amount allowable to sell short (usually 20% to 40%). The proceeds of the short sales are used to buy more long positions, so that net market exposure is equal to 100%, though the portfolio return is expected to exceed that of the S&P 500 Index.

International Equity

Diversified portfolio of company stocks incorporated outside of the U.S. that may be denominated in non-U.S. currency. International equity is expected to provide diversification with U.S. equity investments. Index/Passive international equity management attempts to replicate performance and characteristics of the applicable index and may be implemented through direct stock holdings, mutual funds, commingled funds or the use of swaps or other derivative instruments. Active management attempts to add value over the benchmark through country allocation, stock selection, etc.

Private Equity

Diversified portfolio of partnerships in venture capital, leveraged buyouts, mezzanine debt, and special situations. The portfolio will consist of domestic and international partnerships, as well as private and public securities, which may be the result of distributions. Private equity investments shall be well diversified by sub-asset class (e.g. venture capital vs. buyouts), investment style (e.g. early vs. late stage, mid market vs. large cap market), and vintage year.

Absolute Return

Diversified portfolio of hedge funds consisting of multiple funds and strategies, managed to an overall risk level and including acceptable leverage levels. ARS portfolios seek to produce return patterns over time that have a low level of correlation with equities and other traditional asset classes.

Real Return/Oppportunistic

Real Return/opportunistic can include such diverse individual strategies as commodities and timber, or a portfolio including a variety of asset classes managed tactically or strategically to achieve a real return goal. They are included in the portfolio to provide an inflation hedge or opportunistic tactical or strategic asset class exposure. Examples of additional individual strategies include, but are not limited to TIPS and Infrastructure.

Real Estate

Diversified portfolio of equity or debt investment in real estate including but not limited to commercial, retail, hotel, industrial, residential, or land. Real estate investments may include investments in public or private real estate operating companies and non-traditional property types (e.g., self storage) or other real estate related investments. The real estate portfolio is expected to provide diversification from traditional capital market risk. The real estate portfolio shall be diversified by property type and geography, and may include the use of leverage.

Fixed Income

Diversified portfolios of fixed income securities designed to primarily protect principal and generate cash flow. Internally managed portfolios shall consist of bonds that are either investment grade or meet the requirements of Section 17(1)(a)(iii) of P.A. 314, which states:

“if the net earnings of the issuing, assuming, or guaranteeing entity available for fixed charges during each of any 3, including 1 of the last 2, of the 5 fiscal years immediately preceding the time of investment, shall have been not less than 1-1/2 times the total of the entity’s fixed charges for such year . . .”

Externally managed bond portfolios seek to outperform the bond indices through traditional fixed income management tools such as yield curve management, non-core sector exposure, duration management, and other techniques. The overall total portfolio quality of these portfolios should be maintained at above investment grade.

Cash/Short-Term Fixed Income

Portfolio of short-term fixed income securities with an average maturity of less than one year. Its purpose is to provide liquidity and safety of principal from capital market and default risk.

V. Performance Objectives

The investment performance of the fund will be measured on two levels: against objectives for the total MPSERS and against objectives for individual portfolio components (asset classes and individual managers). Investment performance shall be measured no less than quarterly on a net of fees basis. Because capital markets fluctuate, and given the length of the duration of the liability stream, the performance relative to objectives is to be judged over a period of a market cycle as well as standard annualized periods of one, three, five, and ten years. Greater emphasis is placed on intermediate to long-term results.

A. Performance Objectives for the MPSERS

1. Achieve optimal rate of return possible within prudent levels of risk, while maintaining sufficient liquidity to pay benefits.
2. Diversify assets to preserve capital and avoid material losses.
3. Meet or exceed actuarial assumption over the long term.
4. Perform in the top half of the public plan universe over the long term.
5. Exceed individual asset class benchmarks over the long term.
6. Exceed the median peer within the appropriate manager or asset class universe ranking over the long term, making qualitative and quantitative adjustments for universe comparisons which may only be available gross of fees.
7. Achieve a rate of return in excess of inflation.

B. Performance Objectives for Individual Components

It should be noted that peer universes may only be available for these comparisons on a gross of fees basis. This should be considered when evaluating SMRS return streams which are stated net of fees.

- | | |
|---------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1. Domestic Equities | Meet or exceed the total return of the S&P 1500 Super composite for one, three, and five-year periods and a market cycle |
| Index/Passive | Return within 20 basis points of the S&P 500 Index, 50 basis points for the S&P 400 mid-cap, and 60 basis points for the S&P 600 small-cap over one, three, and five-year periods and a market cycle. |
| Active management | Exceed the most relevant S&P Index (or the most relevant Russell Index), adjusting for market capitalization and style, for one, three, and five-year periods and a market cycle.
Rank above median in a universe of managers possessing a similar market cap and style characteristics. |
| 2. International Equities | Meet or exceed the total return of the S&P/Citigroup BMI -World ex-US with 25% of the currency hedged for one, three, and five-year periods and a market cycle. |
| Index/Passive | Return within 250 basis points of the S&P/Citigroup BMI-EPAC Index with 25% of the currency hedged for one, three, and five-year periods and a market cycle. Return within 400 basis points of the MSCI Emerging Markets Index, for one, three, and five-year periods and a market cycle. |
| Active management | Exceed the most relevant S&P Index (or the most relevant Russell Index), adjusting for market capitalization, style and geography for one, three, and five-year periods and a market cycle.
Rank above median in a universe of managers possessing a similar market capitalization, style and geography characteristics. |
| 3. Private Equity | Exceed the S&P 500 Index by 300 basis points over one, three, and five-year periods and a market cycle. |

4. Absolute Return Exceed T-bills by 400 basis points net of fees over the one, three, and five-year periods and a market cycle. Also, exceed the appropriate HFN Fund of Funds median net of fees over one, three, and five-year periods and a market cycle.
5. Real Return/Oppportunistic Exceed the increase in the CPI by at least five percent (5%) annually net of fees over one, three, and five-year periods and a market cycle. If a peer universe is available, rank above median in a nationally recognized universe of managers possessing a similar style.
- TIPS - Exceed the Barclays U.S. TIPS Index over one, three, and five-year periods and a market cycle. Rank above median in a nationally recognized universe of managers possessing a similar style.
- Commodities - Exceed the Dow Jones-AIG Total Return Commodities Index over one, three, and five-year periods and a market cycle. Rank above median in a nationally recognized universe of managers possessing a similar style.
- Oppportunistic – Benchmark(s) appropriate to each investment product’s strategic or tactical asset class exposure will be established commensurate with investment.
6. Real Estate Exceed the NPI over the one, three, five-year periods and a market cycle, minus 75 basis points prior to October 2005 and minus 130 basis points thereafter. Exceed the NCREIF-ODCE over one, three, and five-year periods and a market cycle.

7. Fixed Income/Gov	Exceed the Barclays U.S. Government Index over one, three, and five-year periods and a market cycle. Rank above median in a nationally recognized universe of managers possessing a similar style.
Fixed Income/Corp.	Exceed the Barclays U.S. Credit Index over one, three, and five-year periods and a market cycle. Rank above median in a nationally recognized universe of managers possessing a similar style.
Fixed Income/High Yield	Exceed the Barclays U.S. High-Yield Index over one, three, and five-year periods and a market cycle. Rank above median in a nationally recognized universe of managers possessing a similar style.
Fixed Income/Core, Core+	Exceed the Barclays Aggregate Index over one, three, and five year periods and a market cycle. Rank above median in a nationally recognized universe of managers possessing a similar style.

VI. General Investment Manager Guidelines and Requirements

- A. Purchases and sales, security selection, and portfolio implementation of investment strategies are delegated to the discretion of the investment manager, subject to compliance with MPSERS' investment policies, individual contracts, and P.A. 314. If a commingled vehicle or mutual fund is utilized, the investment policies of that fund shall be considered the operative policy document.
- B. The following transactions are prohibited: Purchase of any securities or execution of any other transactions prohibited by P.A. 314.
- C. Transactions that involve a broker acting as a "principal" where such broker is also the investment manager who is making the transaction are prohibited. Brokers acting as investment managers are limited to "agency" transactions.
- D. Transactions shall be executed at a reasonable cost, taking into consideration prevailing market conditions and services and research provided by the executing broker.
- E. MPSERS considers the active voting of proxies an integral part of the investment process. Proxy voting will occur in accordance with the Proxy Voting Policy incorporated by attachment and is delegated to the investment managers.
- F. All external managers shall adhere to the *Investment Protection Principles set forth in Executive Directive 2003-11*.

- G. All internal managers shall adhere to the Bureau of Investments' *Standards of Professional Conduct*. As part of the *Standards of Professional Conduct*, the BOI has a personal trading policy in place that requires that all BOI employees (including the State Treasurer and Chief Deputy Treasurer) obtain pre-approval for certain personal investments transactions and abide by specified ethical standards.
- H. All managers will be expected to provide MPSERS, the custodian, and their investment consultant, on a timely basis each quarter, such data as is required for proper monitoring.
- I. No more than 5% of the MPSERS portfolio at cost may be invested in the securities of a single issuer or in a single tangible asset, excluding securities issued by the U.S. government or its agencies.
- J. No fixed income security shall have an equivalent credit quality below investment grade at the time of purchase defined as:
- BBB- by Standard & Poors for straight bonds and convertibles.
- Baa (3) by Moodys Investor Service for straight bonds and convertibles.
- Unless such security meets the requirements of Section 17(1)(a)(iii) of P.A. 314, which states:
- “if the net earnings of the issuing, assuming, or guaranteeing entity available for fixed charges during each of any 3, including 1 of the last 2, of the 5 fiscal years immediately preceding the time of investment, shall have been not less than 1-1/2 times the total of the entity's fixed charges for such year . . .”
- For short-term securities, within the two highest ratings established by at least two national rating services.
- K. The use of index futures is permitted to achieve the following:
1. To reduce the opportunity cost caused by “cash drag” in a rising market.
 2. To decrease the transaction costs of trading without increasing the risk (volatility) of that component of MPSERS.
 3. To increase the manager's flexibility in meeting the performance objectives set forth for them within defined investment style and strategy constraints.
- L. Futures must be used in accordance with Public Act 314 of 1965.
- M. The total Real Estate portfolio may be invested in properties located outside of the United States or its territories.
- N. Performance objectives are to be met on a net of fees basis.

- O. All guidelines must be adhered to by internal and external money managers, however, if from time to time an exception to the guidelines shall be deemed appropriate by a manager, it may seek review and approval by the State Treasurer, as sole fiduciary, to make such an exception.

VII. Insider Trading Policy

All internal portfolios will be managed in compliance with the Insider Trading Policy. Buying or selling securities while aware of material non-public (inside) information concerning the issuer of the securities, or improperly disclosing to others such inside information, may constitute fraud under federal and state securities laws and a violation of other legal and regulatory requirements. Inside information also includes information that a Bureau of Investments (BOI) staff member may have concerning State of Michigan Retirement Systems (SMRS) securities positions or trading.

VIII. Review and Modification of Investment Policy Statement

The State Treasurer, as sole fiduciary, will review the Policy at least every two years to determine if modifications are necessary or desirable. If modifications are made, they shall be promptly communicated to all investment managers and other interested persons.

Approved:

By: Robert J. Klein
(Signature)

7-29-10
(Date)

Robert J. Klein
State Treasurer