THE PUBLIC SCHOOL

and

THE PUBLIC EDUCATION EMPLOYEE RETIREMENT SYSTEMS OF MISSOURI

INVESTMENT POLICY

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Adopted by the Board of Trustees August, 1995

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INVESTMENT POLICY

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I. Introduction and Mission Statement

The Public School and The Public Education Employee Retirement Systems of Missouri ('PSRS' and 'PEERS', respectively, and hereinafter collectively referred to as 'PSRS/PEERS' or 'Systems') is a mandatory, cost-sharing multiple-employer retirement system for substantially all full-time employees of all public school districts in the State of Missouri and all public community colleges.[1] Each system is separate by statute; the benefit structures, contribution rates, asset allocations and accounting systems are unique to PSRS and PEERS. Responsibility for the operation and administration of the Systems is vested in a common Board of Trustees (Board), which has a fiduciary responsibility to the Members and Beneficiaries. In recognition of this fiduciary obligation, the Board has adopted the following Mission Statement for the Systems:

Mission Statement

> **The Public School and The Public Education Employee Retirement Systems of Missouri** work in partnership with the member school districts of this state to provide eligible employees and their beneficiaries with a significant source of income based on the employee's length of service and compensation in order to enhance retirement, disability and death benefits received from other sources.
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> It is the fiduciary responsibility of those charged with administration of PSRS/PEERS to:
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> - Effectively collect contributions,
> - Prudently invest the assets to obtain optimum returns,
> - Equitably provide benefits, and
> - Impartially and in accordance with applicable law administer the benefit programs.
>
> The Board of Trustees and staff are committed to providing services to the members and beneficiaries professionally, promptly, courteously, and efficiently.

The purpose of the Mission Statement is twofold. First, it provides broad operational direction to the Board, Staff and external contractors. Second, it makes an explicit commitment to the Members and Beneficiaries of the Systems regarding the provision of retirement benefits. With the Systems' Mission Statement as a basis, the Board has adopted this Investment Policy document.

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[1] *Exceptions are the school districts of St. Louis and Kansas City, and non-teacher employees of St. Louis Community College. These groups are not covered by either PSRS or PEERS..*

II. Statement of Purpose of Investment Policy

This document outlines the investment philosophy, objectives, and practices of PSRS/PEERS and has been developed to serve as a reference point for the management of the Systems' assets. To assist the Systems' participants in achieving their financial security objectives, the Board has adopted a long-term plan by which the assets of the Systems will be maintained and enhanced through prudent investments. This plan is intended to ensure that the level of assets is adequate to cover the accumulated liabilities of the Systems. **This is an official policy document of PSRS/PEERS. Adoption of this Investment Policy supersedes any prior Investment Policy document(s). Deviation from this document is not permitted without explicit written permission, in advance, from the Board.**

In developing its Investment Policy, the Board understands and accepts its fiduciary obligations to the Members and Beneficiaries of the Systems. These obligations are legal in nature, and are outlined in Section 105.688. of the Revised Statutes of Missouri. The statute is reproduced below and incorporated in its entirety as part of this Investment Policy:

> The assets of a system may be invested, reinvested and managed by an investment fiduciary subject to the terms, conditions and limitations provided in sections 105.687. to 105.689. An investment fiduciary shall discharge his or her duties in the interest of the participants in the system and their beneficiaries and shall:
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> > (1) Act with the same care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a similar capacity and familiar with those matters would use in the conduct of a similar enterprise with similar aims;
> >
> > (2) Act with due regard for the management, reputation, and stability of the issuer and the character of the particular investments being considered;
> >
> > (3) Make investments for the purposes of providing benefits to participants and participants' beneficiaries, and of defraying reasonable expenses of investing the assets of the system;
> >
> > (4) Give appropriate consideration to those facts and circumstances that the investment fiduciary knows or should know are relevant to the particular investment or investment course of action involved, including the role of the investment or investment course of action plays in that portion of the system's investments for which the investment fiduciary has responsibility. For purposes of

this subdivision, "appropriate consideration" shall include, but is not necessarily limited to a determination by the investment fiduciary that a particular investment or investment course of actions is reasonably designed, as part of the investments of the system, to further the purposes of the system, taking into consideration the risk of loss and the opportunity for gain or other return associated with the investment or investment course of action; and consideration of the following factors as they relate to the investment or investment course of action:

(a) The diversification of the investments of the system;

(b) The liquidity and current return of the investments of the system relative to the anticipated cash flow requirements of the system; and

(c) The projected return of the investments of the system relative to the funding objectives of the system;

5) Give appropriate consideration to investments which would enhance the general welfare of this state and its citizens if those investments offer the safety and rate of return comparable to other investments available to the investment fiduciary at the time the investment decision is made.

The statute provides the foundation for development of the Systems' Investment Policy. The language in the statute is complex. For brevity and clarity, the Board hereby adopts the following interpretation of the statute as its "Guiding Principles":

Principles Guiding PSRS/PEERS's Investment Activity

1. *Act in the exclusive interest of the Members of the Systems.*
2. *Maximize total return within prudent risk parameters.*
3. *Preserve the long-term purchasing power of the fund.*

These principles, combined with the applicable sections of the Revised Statutes of Missouri, serve as the basic guideline for this Investment Policy document.

III. Investment Philosophy

The Systems' Mission Statement indicates that among its key duties is provision of benefits to Members. In order to do so the Systems must accumulate and maintain the liquid financial reserves necessary to fulfill this obligation.

Liquid financial reserves shall be obtained from three sources: (1) Contributions from the Members of the Systems; (2) Contributions from Employers; and (3) Return on Investments. The Systems are contributory by statute; for purposes of developing this Investment Policy, the Systems assume at this time that the stream of contributions from Members and their Employers will continue in the future and remain an important source of funding. More important than the level of contributions, in terms of total dollar impact, is the return on investment of the assets of PSRS/PEERS. Based on general beliefs about the long-term investment returns available from a well-diversified, prudently invested portfolio, the Board has adopted the following Total Fund Investment Objective:

Total Fund Investment Objective

> *The goal of the PSRS/PEERS investment strategy is to achieve a **total real rate of return of at least 4.5 percent per annum over time**.*[2]

In order to achieve this real rate of return, the Board will rely on an investment strategy utilizing an appropriate long-term, diversified asset allocation model. The purpose of diversification is risk minimization. Diversification generally should be along the following lines: asset classes (stocks, bonds, cash, real estate, etc.), countries, industries, investment styles, capitalization ranges and maturity sectors. Other considerations in asset allocation modeling should take into account the purpose of the Systems, the size and financial condition of the Fund, and general business conditions. The factors mentioned here are not intended to be limiting; rather, they are outlined as a general indication of the importance of diversification to proper asset allocation. The Board will determine the proper allocation among asset classes and investment managers, based on advice and analysis provided by the Investment Staff and/or External Asset Consultant(s).

Investment managers will be given specific tactical roles within the overall strategic investment plan. Depending on their assignments, managers may be judged on some or all of the following: (i) consistency of philosophy, style, and key personnel, (ii) performance relative to an appropriate index or proxy group, and (iii) ability to add incremental value after costs. The Investment Staff and Consultant will provide continual performance monitoring and supervision of the Systems' managers, and provide periodic

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[2] *The real rate of return is the rate by which the long-term total return exceeds the long-term inflation rate. The Board shall employ an actuarial consultant for purposes of determining the inflation rate to be used in calculating the PSRS and PEERS pension obligations. The current assumed inflation rate is three and one-half (3.50) percent per annum.*

updates to the Board. The review focus of the Board will be based on performance relative to appropriate benchmarks and peer performance over time.

The Board recognizes that even though its investments are subject to short-term volatility, it is critical that a long-term investment focus be maintained. This prevents ad-hoc revisions to its philosophy and policies in reaction to either speculation or short-term market fluctuations. In order to preserve this long-term view, the Board has adopted the following formal review schedule[3] :

Formal Review Agenda Item	Formal Review Schedule
Total Fund Performance	Quarterly
Broad Asset Allocation	At least every three years
Manager Structure	At least every three years
Investment Policy	Annually

In determining its philosophy towards risk, the Board has properly considered, in addition to its fiduciary obligations and statutory requirements, the Systems' purpose and characteristics, financial condition, liquidity needs, sources of contribution, income, and general business conditions. Currently, the liquidity requirements of the Systems are not so binding that specific investment decisions are necessary to meet them. The Board is not prevented from structuring a well-diversified investment portfolio, and its commitment to a long-term investment focus should be maintained.

IV. Roles and Responsibilities

PSRS/PEERS is one of the larger public pension funds in the United States; as such its operational requirements are complex. In order to properly administer the Systems and carry out investment strategies, the Board relies heavily on both Internal Staff and external contractors. Because of the number of parties involved, their roles as fiduciaries must be clearly identified to increase operational efficiency, to ensure clear lines of responsibility, to ensure proper controls and to reduce or eliminate duplication of effort.

<u>Board of Trustees</u>
The PSRS/PEERS Board is responsible for prudent utilization of the Systems' funds and assets involving retirement and disability benefit plans. The Board has the responsibility of establishing and maintaining policies and objectives for all aspects of the Systems' operation, including establishing contribution rates and administrative policies.

Specifically with regard to the investment process, the Board relies on the recommendations of its Investment Staff and Consultant prior to taking investment action. The following are examples of Board-level investment decisions:

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[3] *The Board reserves the right to review any of these topics at any time. This formal schedule is set forth for long-term planning purposes only.*

1. Approval of formal policies related to the investment program.
2. Determination of long-term policies for risk tolerance and asset mix.
3. Approval of manager structure.
4. Retention or termination of investment managers.

The Investment Staff and Consultant will provide information addressing investment activities to the Board both prior to and during its regular meetings. After briefings by Staff and Consultant on any topics or issues pertinent to the Systems' investment operations, the Board will determine what action, if any, is necessary. Assuming that the long-term plan, asset allocation and investment managers are properly structured, the general course of action for the Board will be to recommend only modest changes in direction.

Executive Director

The Executive Director (Director) is appointed by, and serves at the pleasure of the Board. The Director is responsible for planning, organizing, and administering all operations of the Systems under the broad policy guidance and direction of the Board. The Director, with the assistance of the Investment Staff, monitors the performance of the investment portfolio; ensures that funds are invested in accordance with Board policies; studies, recommends, and implements policy and operational procedures that will enhance the investment programs of PSRS/PEERS; and ensures that proper internal controls are developed to safeguard the assets of the Systems. In fulfilling these responsibilities, the Director relies heavily on the Chief Investment Officer and Consultant.

Internal Investment Staff

The Internal Investment Staff provides internal investment management and consulting support to the Board and Director. The primary functions of the Investment Staff include analyzing the overall asset allocation of the Systems and its portfolio structure; providing technical advice; screening and monitoring external managers to ensure compliance with Board mandates and policies; management of internal programs; serving as a liaison to the investment community; monitoring fund performance and rebalancing assets; and informing and advising the Board and Director on financial, economic and political developments that may affect the investments of the Systems. The Investment Staff also works closely with the Consultant on a project-specific basis. The Chief Investment Officer reports directly to the Director.

Internal Accounting Staff

The Internal Accounting Staff develops and maintains the accounting systems of PSRS. The Accounting Staff identifies and records on a timely basis the valid fiscal transactions of the system, and designs and monitors the internal controls on those transactions so as to insure the integrity of the fiscal information. The Accounting Staff provides the Director and the Board with the financial tools to make informed management decisions, and prepares the external accounting statements and Comprehensive Annual Financial Report (CAFR) in accordance with generally accepted accounting principles (GAAP).

The primary responsibility of the Accounting Staff in the investment process is reconciliation of the System's records with the reports prepared by the Custodian. The Accounting Staff also maintains the System's transaction records and monitors realized and unrealized investment gains and losses. The Accounting and Investment Staff share responsibility for both the management of the cash flow of the System's funds and the maintenance of the System's banking relationships necessary to facilitate that process. The Accounting Staff reports to the Director through the Assistant Executive Director.

Actuarial Consultant

The System may employ an Actuarial Consultant (Actuary) for the purpose of forecasting asset and liability growth and the many complex factors included in estimating future pension costs. These factors include, but are not limited to, interest rates, inflation, investment earnings, mortality rates and employee turnover. These actuarial assumptions are then used to forecast uncertain future events affecting the System. The Actuary shall provide periodic reports on the actuarial valuation of the System, and shall provide recommendations to the Board including, among other things, the estimated level of contributions necessary to fund promised benefits. The Actuary is appointed by, and serves at the pleasure of the Board.

External Asset Consultant(s)

The External Asset Consultant's (Consultant) duty is to work with the Board and Staff to manage the investment process. This includes regular meetings with the Board to provide an independent perspective on the Systems' goals, structure, performance and managers. The Consultant will review asset allocations and performance in conjunction with the Staff, and make recommendations to the Board as appropriate. The Consultant will assist with external manager selection, when needed. The Consultant is also responsible for reviewing internal management programs. In addition to observing financial, economic, and political developments, the Consultant will also monitor changes within the pension and investment communities that may affect the Systems. The Consultant will promptly inform the Board and discuss the impact of material changes taking place within any current or potential manager's investment process or organizational structure. The Consultant is appointed by, and serves at the pleasure of the Board.

External Investment Managers

The external investment managers (managers) will be selected by, and serve at the pleasure of, the Retirement Systems. Managers will be given explicit written directions detailing their particular assignments, and will construct and manage investment portfolios that are consistent with the investment philosophy and disciplines for which they were hired. They will select, buy, and sell specific securities within their guidelines and in adherence to other policies set forth by the Systems. Discretion is delegated to the managers to carry out investment actions as directed by the Systems. Managers will provide performance reporting to the Staff utilizing standardized reporting formats at intervals specified by Staff. Specific operational information for each manager is addressed at length in the Operating Manual.

Custodian

The Custodian(s) will collect income and safekeep all cash and securities, and will regularly summarize these holdings, along with both their individual and collective performance, for the Board's review. Performance reports will be provided by the Custodian at intervals specified by Staff. In addition, a bank or trust depository arrangement will be utilized to accept and hold cash and to invest such cash in liquid, interest-bearing instruments. The Custodian engages in a Securities Lending program.

V. Asset Allocation

PSRS/PEERS's investment assets are divided into general classes such as domestic stocks, non-U.S. stocks, and bonds. It is common practice to construct portfolios using combinations of asset classes in order to improve the risk/return profile. This concept is called diversification, and was discussed briefly in Section III. The asset allocation decision is generally regarded as the most important decision to be made in the investment management process. Studies have indicated that approximately 85 percent of the variability in an investment portfolio's return can be attributed to the asset allocation decision.

In order to determine the appropriate mix of asset classes in a portfolio, five factors must be considered:

1. appropriate asset classes for investment,
2. the expected rate of return for each asset class,
3. the estimated risk of each asset class (expressed as the standard deviation of the rate of return),
4. the correlation between the rates of return of the asset classes, and
5. the investment objectives and risk constraints of the fund.

Once an analysis of these factors is completed, the asset mix which produces an optimal risk/return tradeoff can be determined. As stated in Section I, PSRS/PEERS consists of two distinct systems: The Public School Retirement System and The Public Education Employee Retirement System. It is therefore necessary to conduct two separate asset allocation studies. While the methodology for each study is the same, differences in plan characteristics may produce distinct results. Based on its determination of the appropriate risk tolerance for each System, and its long-term return expectations, the Board has adopted the following broad asset allocation guidelines for PSRS/PEERS:

THE PUBLIC SCHOOL RETIREMENT SYSTEM OF MISSOURI	
Asset Class	***Allocation***
Domestic Equity Investments	37.00%
Non-U.S. Equity Investments	18.00%
Fixed Income Investments	32.00%
Real Estate	5.00%
Real Return Pool Investments	5.00%
Private Equity Investments[4]	3.00%

Within each broad asset class there exist numerous investment styles and philosophies in which the Systems' assets may be invested. The Board shall make these Manager Structure decisions based on the advice and recommendations of the Investment Staff and Consultant. These allocations shall be included in the Operating Manual. As stated in Section III, a formal review of the Manager Structure shall be conducted at least every three years by the Board, in conjunction with a formal Broad Asset Class Allocation review.

THE PUBLIC EDUCATION EMPLOYEE RETIREMENT SYSTEM OF MISSOURI	
Asset Class	***Allocation***
Domestic Equity Investments	37.00%
Non-U.S. Equity Investments	18.00%
Fixed Income Investments	32.00%
Real Estate	5.00%
Real Return Pool Investments	5.00%
Private Equity Investments[4]	3.00%

Cash held by managers can be disruptive to the allocation process. Managers are therefore expected to be fully invested at all times, with the exception of brief periods between the sale of an existing security and the purchase of a replacement security. The Board may choose to hire managers specializing in market timing; these managers may be authorized to hold cash. Absent specific prior written Board authorization, no manager shall hold more than five (5) percent of their allocated funds in cash.

Performance Objectives

Generating a total real rate of return net of expenses of at least 4.5 percent per annum is an important consideration in the asset allocation decision and the primary performance objective for the Total Fund over long periods of time. The need for a long-term focus is necessary to preclude the temptation to overreact to events in the financial markets that have no relevance to long-term asset/liability management. The resulting dilemma is the

[4] *The Board has adopted a 3% allocation to private equity. In the interim (prior to funding) 2% of the allocation is directed to fixed income and 1% to domestic equity.*

conflicting need to evaluate investment policy implementation over shorter time periods while maintaining a longer-term focus on meeting the 4.5 percent real rate of return objective. In order to determine if the Systems' shorter-term and long-term objectives are being achieved, it is necessary to develop multiple benchmarks by which the Systems' progress may be judged. These benchmarks allow the Systems to be judged (1) by performance relative to broad market indices (i.e., performance relative to a policy benchmark that reflects the Systems' asset allocation, (2) by long-term performance relative to its actuarial assumptions, and (3) by performance relative to other public pension systems and their investment managers as a reference point of oversight. The stated objectives of the investment management process are as follows:

1. *To equal or exceed over a market cycle a policy benchmark that reflects the Systems' asset allocation. The policy benchmark will change over time as the Systems' asset allocation changes with Board decisions, the funding of asset classes, and other facters. The current long-term asset allocation objective for the Systems results in a policy benchmark comprised of:*

THE PUBLIC SCHOOL RETIREMENT SYSTEM OF MISSOURI	
Market Index	**Proportion**
Russell 3000 Domestic Stock Index	37.00%
MSCI AC World Free Ex US (Gross Divs)	18.00%
Customized Fixed Income Benchmark[5]	32.00%
Customized Real Estate Benchmark[6]	5.00%
Lehman Brothers TIPS Index	5.00%
Russell 3000 Domestic Stock Index + 300 basis points	3.00%

THE PUBLIC EDUCATION EMPLOYEE RETIREMENT SYSTEM OF MISSOURI	
Market Index	**Proportion**
Russell 3000 Domestic Stock Index	37.00%
MSCI AC World Free Ex US (Gross Divs)	18.00%
Customized Fixed Income Benchmark	32.00%
Customized Real Estate Benchmark	5.00%
Lehman Brothers TIPS Index	5.00%
Russell 3000 Domestic Stock Index + 300 basis points	3.00%

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[5] *The Customized Fixed Income Benchmark is comprised of 95 percent Lehman Aggregate Index and 5 percent Merrill Lynch High Yield Master Index II.*

[6] *The Customized Real Estate Benchmark is described fully in Section III of the Real Estate Implementation Manual included with this Policy document as Appendix XI. It is comprised of a portfolio weighted combination of the NCREIF Property Index (NPI) and the NAREIT Equity Index.*

2. To earn a rate of return, after fees, of 4.5 percent in excess of plan liability inflation.

There will be meaningful short-term variations from thisobjective; the Board believes, however, that over the long-term (market cycle to market cycle) this goal should be attainable.

3. To perform adequately on a risk-adjusted basis relative to other similar institutional investors and their external investment managers.

In the short-term, individual managers employed by the Systems will not be measured against the aggregate fund objective nor against the real rate of return target outlined above. Managers may be evaluated:

1. against appropriate market indices on both a risk-adjusted and nominal basis;
2. against peers within their style groups;
3. on adherence to their stated investment styles; and
4. on adherence to investment guidelines.

Performance expectations for each manager will be determined by the Investment Staff and the Consultant. The specific performance criteria for each manager will be outlined in the Operating Manual.

VI. Permissible Investments

The Retirement Systems invest in a broad array of investment vehicles across the primary asset classes of domestic equity, non-U.S. equity, fixed income, real return securities, real estate and private equity. Securities permitted by the Systems fall under the following basic categories: 1) traditional investments (i.e., stocks, bonds, etc.), 2) private investments (i.e., private equity and private real estate), 3) and non-traditional investments such as derivative securities, short selling and currencies. Each manager retained by the Sytems is given specific instructions with regard to permissible investments relevant to their tactical role in PSRS/PEERS's investment process. For each manager, the description of allowed investment vehicles is included in the Systems' Investment Guidelines for that particular manager.

Additional Information:

- Assets may be held in commingled funds, privately managed separate accounts, and/or investment partnerships.
- Investments in commingled funds shall be evaluated on a case-specific basis through analysis of the fund's 'offering document'. The 'offering document' shall become the specific investment guidelines for that particular allocation, along with any additional terms negotiated and agreed upon in writing between the investment manager and PSRS/PEERS.
- Investments may be made through investment partnerships and joint ventures. These practices are most common within the real estate and private equity asset classes.
- Investments may not be made in any investment that is prohibited by the Internal Revenue Service or statutory restrictions.

- The securities representing debt and equity of any one company shall not exceed 5.0 percent of the market value at cost of any manager's portfolio except for securities of the U.S. government without specific written approval in the manager's Investment Guidelines.
- All investments made shall be subject to the quality and diversification restrictions established by Section 105.688. of the Revised Statutes of Missouri.
- Derivative securities that are highly leveraged or are being used for purposes of speculation may not be used without prior review and express written authorization from the Board. Futures and options may be used by investment managers to obtain asset class exposure with uninvested cash, to equitize dividend receivables, or for yield curve management.
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Securities Lending

The Board may elect to hire a Securities Lending Investment Agent (Agent) to lend financial securities of the fund. Any income from this activity will be deposited upon receipt in a pre-specified short-term investment vehicle or vehicles. The Agent may lend financial securities (including but not limited to U.S. and non-U.S. equities, corporate bonds and U.S. and non-U.S. government securities). This Agent shall continually review the creditworthiness of potential borrowers through adequate analysis of publicly available information and any other material available to them. No more than thirty (30) percent of the Systems' securities on loan shall be loaned to any one borrower. All loans shall be fully collateralized with cash, securities or irrevocable bank letters of credit. Collateralization of such loans shall be at least 102 percent domestic (105 percent international) of the market value of the loaned securities plus accrued income for U.S. and non-U.S. loans, respectively. Securities on loan should be marked-to-market on a daily basis to assess adequacy of collateralization. The Agent shall provide quarterly performance reports to the Staff. The Securities Lending program shall in no way inhibit the trading activities of the other managers of the Systems.

VII. Responsibilities of External Investment Managers

General Manager Guidelines

PSRS/PEERS utilizes external investment managers to implement its investment programs. These managers have demonstrated expertise with particular asset classes and/or management styles. In order to be considered for an assignment, a manager must have a level of assets under management so that the addition of funds from PSRS/PEERS will not cause the assets of the Systems to exceed 25 percent of the manager's total assets in the product. Each investment manager shall be a registered advisor under the Investment Advisers Act of 1940 (or shall be appropriately exempt from registration). Individual investment guidelines will be set for each manager. These guidelines will be specific as to the particular role of that manager's portfolio in the overall investment structure, and will address the following topics:

- Permissible Investments
- Style Adherence
- Diversification
- Portfolio Quality Requirements
- Performance Objectives
- Manager-specific Issues

Managers will be delegated the duties of sector and security selection, portfolio quality and timing of purchases and sales (including broker selection), subject to their specific guidelines. Compliance with these guidelines is mandatory. No deviation will be permitted without express written permission, in advance, from the Board.

Communication

An external manager employed by the Board is expected to communicate, in writing, any developments that may impact the Systems' portfolios to the Staff and Consultant within five (5) business days of occurrence. Examples of these events include, but are not limited to:

- a significant change in investment philosophy;
- a significant shortfall in performance relative to the assigned benchmark for the most recent quarter;
- a loss of one or more key management personnel;
- a new portfolio manager being assigned to the Systems' accounts;
- a change in the ownership structure of the manager's firm; or
- any occurrence which might potentially impact the management, professionalism, integrity or financial position of the investment management firm.

Additionally, managers will be responsible for meeting with the Investment Staff at least once per year in person and as requested through audio and/or video conference calls. The Investment Staff will coordinate with the manager to arrive at acceptable meeting dates.

Benchmarks

All investment managers will be judged against appropriate benchmarks. Each manager's benchmark will reflect that manager's particular style or strategic role in PSRS/PEERS's investment process. Each benchmark will be clearly specified, measurable and investable. Benchmarks do not have to be published or widely recognized; they may be "customized" for a particular investment style(s). The proper benchmark shall be determined in advance of funding by mutual agreement between the manager, Staff, and Consultant.

Performance Reporting

All investment managers under contract with PSRS/PEERS will report investment performance to Staff on a quarterly basis. **The Systems require public market managers to utilize a standard reporting format. There will be no exceptions to this**

requirement. A blank copy of this form is included in the Operating Manual. Managers may however provide their standard performance reports as supplemental information to the PSRS/PEERS standardized report. Please refer to the following section of this document for more information.

Ramification of Non-Compliance

All investment managers are employed at the pleasure of the Board, with a five-day termination notice provision in PSRS/PEERS's standard manager contract. Failure to follow these generic guidelines, and/or the manager-specific guidelines as set forth in the Operating Manual may result in termination.

VIII. Performance Measurement

Performance reviews are a critical part of the portfolio management process. In fulfilling this duty, the Board will rely on its external investment managers, Consultant(s), Custodian, and Staff. PSRS/PEERS receives quarterly performance reports from the following three sources:

1. **Managers:** shall provide quarterly reports utilizing a standardized reporting format specified by the Staff. There will be no exceptions. Managers may provide their standard performance information in a different format as supplemental information only, at their discretion.

2. **Custodian**: shall provide monthly performance reports to the Investment Staff. These reports shall detail the individual performance of managers and the overall performance of the fund. In addition, the Custodian shall report the results of any securities lending activities to the Investment Staff on a quarterly basis.

3. **Consultant:** shall provide verification of performance numbers generated by the Custodian on a quarterly basis. Additionally, the Consultant shall provide performance reports to the Board on all internal investment management functions. This information shall be presented to the Board by the Consultant at regular Board meetings. These reports will include, at a minimum, comparison with the Total Fund Objectives.

Staff will be responsible for ensuring that performance reports are received in a timely manner from these parties, and will provide continual supervision of the performance reporting on the portfolio.

IX. Implementation

The Board recognizes that the complex investment processes of PSRS/PEERS require a substantial amount of daily attention. It is clear that the Board, meeting periodically, cannot oversee the day-to-day operations of the investment function. In order to promote operational efficiency in the implementation of its Investment Policy, the Board has employed various parties to carry out these duties. The efficiency of operations are critically dependent on the proper delegation and coordination of clearly defined assignments among the various parties listed in Section IV of this document.

This Investment Policy has been written with the intent of providing a broad operational outline, or *reference point*, for implementing the investment philosophy and practices of PSRS/PEERS. Properly structured, a policy document of this nature should require little revision over time. Technical details have been intentionally omitted from this document, due to the volume and complexity of these issues. This information is included in PSRS/PEERS's Investment Policy Operating Manual (Manual). This is a separate binder which is available for public inspection in the central files of PSRS/PEERS's Investment Department. Where applicable, the Manual should contain information which is no more than one year old. Dated information may be removed and kept in Staff files. The Manual will be maintained by PSRS/PEERS's Internal Investment Staff, and will contain the following information:

Asset Allocation Assumptions

Section V of this Investment Policy contains a general discussion of the asset allocation process and the end results of the model; more detailed information, including the inputs and assumptions used in the process will be included in the Operating Manual. An important part of the Manual is detailed information regarding the allocation and rebalancing of assets between asset classes and within the Manager Structure. The Manual will also contain summaries of all portfolio rebalancing activities by Staff.

Specific Manager Guidelines

The investment manager guidelines have been previously outlined in Section VII of this document. The Manual contains specific guidelines outlining the tactical role of each individual manager within PSRS/PEERS's investment strategy. These guidelines shall include, but are not limited to, general information on each manager, specific descriptions of assignments, communication requirements, proxy voting responsibilities, benchmarks, and performance reporting requirements. These specific guidelines will be agreed upon by Staff, Consultant, and the manager in advance of funding.

Performance Measurement

The performance measurement section shall contain at least the most recent year of quarterly performance information for each manager employed by PSRS/PEERS.

Cost Management

This section of the Manual shall contain summary information provided by managers about their management fees, brokerage commission expenses, and use of soft dollars.

Miscellaneous Information

The Manual may also include other information pertinent to the investment operations of the Systems, as deemed appropriate by the Board, Director, and or Investment Staff.

X. Glossary of Terms

Asset Allocation Decision - choosing among broad asset classes such as equities, fixed-income securities and real estate.

Beneficiary - the present or potential recipient of a benefit.

Brokerage Commission - payment for administrative costs incurred in trading securities; the cost of execution.

Commingled Fund - a pooling of funds from multiple investors, managed as one account. The client owns units in the pool; similar to a mutual fund.

Diversification - spreading a portfolio over many investments to avoid excessive exposure to any one source of risk.

Electronic Crossing Network - an increasingly popular and cost-effective means of trading securities where issues are traded by computer either intra-day or overnight. Reduces or eliminates market impact of trading and brokerage commissions.

Derivative - a financial obligation that derives its precise value from the value of one or more other instruments (or assets) at that same point in time.

Equity Investment - claims held by the residual owners of a firm. May also be referred to as common stock.

Fiduciary - one who can exercise discretionary authority or can control important aspects of a pension plan's management.

Fixed Income Investment - a security issued by a borrower that obligates the issuer to make specified payments to the holder over a specific period. May also be referred to as "debt" or "bonds".

Futures – an exchange traded contract providing for the forward delivery of a security, commodity or bundle of such instruments at pre-specified prices. Some futures require cash settlement rather than actual delivery.

Marked-to-Market - revaluation of securities to market value.

Private Placement - issuance of debt or equity directly to an investor or investors.

Proxy - an instrument empowering an agent to vote for a shareholder.

Rebalancing - realigning the proportions of assets in a portfolio as needed.

Risk - the uncertainty of outcome or the likelihood of a loss.

Separate Account - funds managed on an individual account basis; no pooling with other investors. The client owns the securities.

Short-Term Investments – any fixed income investment with less than one year to maturity.

Soft Dollars - the value of goods or services that brokerage houses supply to investment Managers "free of charge" in exchange for the investment Managers' business.

Total Return - interest or dividend income plus any realized or unrealized capital gain (or loss) on an investment.