Adopted by the Board of Retirement on February 22, 2000

ORANGE COUNTY EMPLOYEES RETIREMENT SYSTEM

INVESTMENT POLICY STATEMENT

Background

The Orange County Employees Retirement System was established in 1945 under the County Employees Retirement Law of 1937. The retirement system exists to provide retirement, disability and death benefits for qualified employees of Orange County and participating special districts.

The retirement system is governed by the Board of Retirement (Board). The Board has the sole authority over the investment portfolio and may delegate responsibilities to the investment staff and external advisors.

I. Purpose of Investment Policy Statement

The purpose of the Investment Policy Statement is to assist the Board in effectively supervising, monitoring, and evaluating the investment of the assets of the system by:

- Stating the Board's views, expectations, objectives and risk tolerance for the investment of all assets of the system.
- Formulating an investment structure for managing all assets. This structure includes (1) diversified asset allocation with acceptable ranges and (2) a combination of investment management styles, to produce a sufficient level of overall diversification.
- Setting procedures for policy implementation.
- Providing guidelines for each investment portfolio to control the overall risk.
- Establishing criteria to monitor and evaluate the performance of the fund and investment managers.

II. Statement of Objectives

1. The overall objective is to invest the assets of the system solely for the benefit of plan participants and beneficiaries while attempting to minimize employer contributions and investment and administration costs
2. The investment program aims to achieve and maintain a fully funded status with regard to the actuarial liability of the system.
3. The investment program will also attempt to maintain a funding cushion for (1) unexpected developments and (2) a reduction in the expected return on investments or interest rate assumption.

III. Investment Policy and Guidelines

1. Time Horizon

The investment policy and guidelines are based on a time horizon of greater than five years. The system's strategic asset allocation is also based on this long-term perspective. Fluctuations of investment results in the interim should be viewed with an appropriate perspective.

2. Risk Tolerances:

Investment opportunities in various asset classes have differing risk and return expectations. In general investments with higher expected returns involve a higher level of risk. The Board recognizes that some level of risk must be assumed to achieve the system's long-term investment objectives. The Board will attempt to achieve its investment return objective with an appropriate level of risk using an efficient combination of investable assets.

3. Liquidity Needs

Sufficient liquidity must be maintained to pay benefits and expenses. Investment income net of appreciation is expected to exceed projected benefit payments and expenses on an annual basis. However, from a cash flow point of view benefit payments and expenses exceed employer and employee contributions due primarily to the county pre funding its actuarial accrued liability. The Board has adopted a plan to meet the cash shortfall by transferring income from manager portfolios.

4. Performance Objectives

The investment returns of the total fund will depend on the asset allocation targets, the mix of investment styles within asset classes and individual manager performance. Therefore, performance objectives have been set at three levels; total fund, asset class and individual portfolios.

a) Total Fund

1. Meet or exceed the actuarial rate of interest. Annualized investment returns (net of fees) in excess of the actuarial interest rate (currently 8%) over five-year periods.

2. Meet or exceed the real rate of return target. Annualized investment returns in excess of inflation as measured by CPI of 3.5%-4.5% over five-year periods.

3. Meet or exceed the policy benchmark. Annualized investment returns (net of fees) in excess of the policy benchmark over five-year periods. The policy benchmark is a composite of the benchmarks of the asset classes in the asset allocation policy. Composition of the policy benchmark is detailed in Appendix 1. Exceeding the policy benchmark will indicate if the investment program as a whole is adding value.

4. Comparison with peer group of funds.
   No specific objective is set in terms of ranking because asset allocation, which primarily determines total fund returns, varies widely between funds. However, the Board will review ranking of the fund in a peer group for informational purposes.

b) Asset Class Level

Annualized returns (net of fees) for the asset classes must exceed their respective benchmarks over a five-year period. The asset class benchmarks will be broad market indices that are representative of the investment structure for that asset class. For example Frank Russell 3000 index of U. S. Stocks, is chosen as a benchmark for U.S. equities since it represents about 98% of the capitalization of the U.S. equity market, is composed of diversified investment styles and is an investable index. Current benchmarks for the asset classes are shown in Appendix 1.

c) Individual Portfolios

Performance objectives for manager portfolios are stated in the respective investment agreements. Returns (net of fees) must exceed the respective benchmarks over three to five-year periods and rank above the median in a peer group. Manager benchmarks will be determined based upon the investment style of the portfolio for which the manager is hired. Benchmarks for manager portfolios are detailed in Appendix 3, 3A and 3B.

5. Asset Allocation

The Board has adopted a strategic asset allocation plan based upon projected actuarial liability, liquidity needs and the risk/return expectations of various asset classes. This asset allocation plan seeks to maximize returns for the level of risk that the Board considers appropriate. The current strategic asset allocation targets and ranges are detailed in Appendix 2. Since projected liability and risk/return expectations may change the Board will conduct a periodic review of the asset allocation plan to maintain an optimal allocation.

5.1 Investment Structure and Style

a. Domestic Equities

The Board has adopted a style diversified structure that is designed to have aggregate domestic equity portfolio characteristics similar to those of the broad market as represented by the Russell 3000 index. This structure will be reviewed periodically to ensure neutrality relative to risk characteristics. That is, there should be no material differences in beta and risk factors such as growth, yield, price to earnings, size of companies, etc.

The Board has approved 40% of domestic equities to be passively managed. This is due to the evidence that a majority of active managers have failed to exceed the index benchmarks over long periods and the fact that passive management reduces overall transaction costs and management fees. The Board will periodically review the use of passive management and adjust targets based on the then current evidence of the benefits of active management.

The current domestic equity structure is detailed in Appendix 3.

b. International Equity

In view of the fact that active managers appear to have better opportunity to add value in international equities, a higher proportion of international equities will be actively managed. Currently 100% of international equities is actively managed. Some passive management may be considered in the future if warranted.

The international equity portfolio shall be broadly diversified across countries outside of the U.S. identified as developed or emerging markets and included in the MSCI All Country World Ex-U.S. Index.

The portfolio shall also be diversified across industry sectors. The current international equity structure is shown in Appendix 3A.

Hedging of currency exposure to control risk will be permitted.

c. Domestic Fixed Income

The domestic fixed income structure is designed to provide diversification across sectors (government, corporate, mortgage, asset backed etc.) maturity segments and quality. The structure will also use a combination of passive and active management. Currently 10% of domestic fixed income is allocated for passive investment. This percentage may be increased if warranted. In order to control risk, managers will have specific guidelines on duration, quality and single issue exposure. The current domestic fixed income structure is attached as Appendix 3B.

d. International Fixed Income

International fixed income is included in the asset allocation to provide diversification. This portfolio will be invested primarily in developed countries and be broadly diversified across such countries. Hedging of currency exposure to control risk is permitted.

e. Real Estate

Real estate is included in the asset allocation to provide diversification from equities and fixed income and to provide income. Real estate investments are privately placed and illiquid. Their valuation is not marked to market daily but is based on annual appraisals.

The investment structure for real estate will consist of allocation ranges for property types and geographic regions. This is intended to provide broad diversification. The current real estate structure is detailed in Appendix 3C.

f. Alternative Assets

Alternative assets include investments in private equity, venture capital, buy-out, distressed debt, oil and gas and timber etc. This asset class has significant risk but also opportunities for high return. These assets are illiquid. Valuation is based on appraisal and not marked to market on a daily basis. Alternative assets are included in the asset allocation to provide further diversification and enhance expected return.

6. Implementation

The Board will establish procedures for the Chief Investment Officer and investment staff to implement board decisions and ensure compliance with Board policies and guidelines.

a. Periodic Review of Asset Allocation Policy

The Board will conduct periodic review of the asset allocation policy with the input of the Investment Consultant, Actuary and staff. The review will be conducted at least every three years.

The Chief Investment Officer will review with the Board the portfolio values and actual versus target asset allocation each month.

b. Rebalancing the Asset Allocation

The Chief Investment Officer will monitor the asset allocation and rebalance to the approved ranges as and when necessary. Any such rebalancing will be reviewed with the Board in the subsequent monthly report.

The Chief Investment Officer will also monitor the investment structure of domestic equity, international equity and fixed income and rebalance to approved targets as and when necessary. Such rebalancing will also be reviewed with the Board in the subsequent monthly report. Whenever practicable major shifts in funds will be discussed in advance with the Board.

c. Cash Requirements

The Chief Investment Officer will ensure that sufficient cash is available to pay benefits and expenses in accordance with the Board approved plan to withdraw cash from income generating portfolios.

d. Manager Monitoring and Compliance

The Chief Investment Officer will monitor investment manager portfolios monthly to ensure compliance with the investment guidelines. The compliance report will be reviewed with the Board on a quarterly basis.

d. Investment Cost Control

The Chief Investment Officer will review the investment costs with the Board annually. The Board will ensure that the investment management costs are reasonable. The use of passive management where appropriate and optimal portfolio size to minimize sliding scale fees are some of the measures used to reduce fees.

e. Performance Review

The Board will review investment performance on a quarterly basis. The performance report will be prepared and presented by the Investment Consultant using performance figures calculated by the Custodian Bank. The performance review will consist of:

1. Total fund performance relative to policy benchmark and attribution.

2. Asset class returns relative to benchmarks.

3. Individual manager performance and portfolio characteristics relative to benchmarks and peer group rankings.

Investment staff will review monthly performance report prepared by the custodian to ensure accuracy.

f. Manager Selection

The Board, with the assistance of the Consultant and staff will select investment managers to manage the assets of the system. The Board will authorize staff and consultant to initiate a search for a manager either to replace a manager or to fill a new mandate approved by the Board. The investment consultant and staff will conduct the search in accordance with criteria established for the search. The search criteria will include the scope of the mandate, the investment style, benchmark and the minimum qualifications for candidates. The minimum qualifications will include successful performance track record relative to benchmark, disciplined investment process, size of assets managed, experience of staff and organizational stability. Staff will perform on-site due diligence on final candidates before the Board interview for selection.

g. Manager Watch List and Termination.

Individual managers are normally evaluated over three to five-year periods. Manager performance will be evaluated against performance objectives stated in the respective manager's investment agreement. The primary measurement is the manager's return versus the benchmark on net of fee basis. A secondary measure is the manager's ranking in a peer group with similar style. Conformance to investment guidelines will also be evaluated.

Significant deviations from the performance objectives or investment guidelines, even over short time periods will cause a manager to be placed on 'watch list' status for closer scrutiny. The Chief Investment Officer is primarily responsible for notifying the investment committees of such instances where a manager is to be placed on watch list. A manager on watch list will have from six months up to a year to improve its standing relative to the specific objectives. If no improvements are observed at the end of the watch list period, the manager may be terminated. A manager may be terminated at any point during the watch list period if further deterioration in performance is observed.

Managers may also be placed on watch list for the following reasons: changes in key personnel, rapid changes in assets under management or clients that could be detrimental to performance, non-responsive communication, and changes in ownership.

Failure of a manager to generate excess returns in a short period should not result in termination. However, the returns must be within an acceptable range of the benchmark. The rankings must also be within an acceptable range.

Managers may be terminated subject to immediate review for reasons of conflict of interest, unethical behavior such as SEC violations or sanctions and violations of the investment management agreement.

Adopted July 12, 1999
Amended August 21, 2000

Appendix 1

Total Fund Performance Benchmarks

Asset Class	Target Allocation	Benchmark
Domestic Equity	33%	Russell 3000
International Equity	14%	MSCI All Country World Ex US
Domestic Fixed Income	34%	LB US Universal
International Fixed Income	5%	SSBI Non US World Govt. Hedged
Real Estate	9%	NCREIF Property Index
Alternative Investments	5%	Actual Return*
Cash	0%	90 Day T- Bill
	100%	

* Actual Return is the return of the OCERS combined Alternative asset manager portfolio.

Adopted July 12, 1999

Appendix 2

Strategic Asset Allocation

Asset Class	Target Allocation	Range
Domestic Equity	33%	31% - 35%
International Equity	14%	12% - 16%
Domestic Fixed Income	34%	32% - 36%
International Fixed Income	5%	4% - 6%
Real Estate	9%	8% - 10%
Alternative Investments	5%	4% - 6%
Cash	0%	0% - 1%
	100%	

Actual allocation to non-publicly traded investments (Real Estate and Alternative Investments) is limited to 15% of total assets.

Adopted July 12, 1999
Amended March 20, 2000

Appendix 3

Domestic Equity Structure

Sub Asset Class	Target Allocation	Benchmark
Large Core Passive	45%	Russell 1000
Large Growth	22%	Russell 1000 Growth
Large Value	22%	Russell 1000 Value
Small Growth	6%	Russell 2000 Growth
Small Value	5%	Russell 2000 Value
	100%	

Adopted January 11, 1999

Appendix 3A

International Equity Structure

Sub Asset Class	Target Allocation	Benchmark
EAFE Plus	90% - 92%	MSCI EAFE
Emerging Markets	8% - 10%	MSCI Emerging Markets Free
	100%	

Adopted July 12, 1999
Amended July 17, 2000

Appendix 3B

Domestic Fixed Income Structure

Sub Asset Class	Target Allocation	Benchmark
Core Index	20%	Lehman Aggregate
Core Plus	63%	Lehman Aggregate
Opportunistic High Yield	17%	50% Merrill Lynch High Yield/ 50% Lehman Aggregate
	100%	

Adopted April 13, 1998
Amended June 18, 2001

Appendix 3C

Total Real Estate Structure

Domestic

Property Type	**Allocation Range**
Apartment	0% - 40%
Office	0% - 40%
Industrial	0% - 40%
Retail	0% - 40%

Regional Diversification	**Allocation Range**
East	0% - 40%
Midwest	0% - 40%
South	0% - 40%
West	0% - 40%

Style	**Allocation Range**
Stable	>/= 70%
Enhanced	0% -30%
High Return	0% -15%

International

The Board adopted to limit International exposure to 15% of total Real Estate at the August 16, 1999 meeting.