State Teachers
Retirement System
of Ohio

Statement Of Investment Objectives & Policy

Statement of Fund Governance

May 15, 2009

State Teachers Retirement
System of Ohio

Statement
Of
Investment Objectives and Policy

Contents

Terms explained in the glossary are *italicized* when they first appear in this document.

1.0 Purpose

1.1 The State Teachers Retirement System of Ohio (“STRS Ohio”) was established for the benefit of the teachers of the public schools of the State of Ohio. STRS Ohio is dedicated to partnering with STRS Ohio members to provide financial performance and member service that assures financial security for current and future retirees.

1.2 The State Teachers Retirement Board of Ohio (the “Board”) is vested with the operation and management of the State Teachers Retirement System of Ohio (“STRS Ohio”) (ORC Section 3307.04). The Board has the full power to invest the assets (the “Fund”) of STRS Ohio (ORC Section 3307.15). The Board is required to “. . . adopt in a regular meeting, policies, objectives or criteria for the operation of the investment program . . .” (ORC Section 3307.15).

1.3 To fulfill the statutory requirement of ORC Section 3307.15, the Board has adopted this Statement of Investment Objectives and Policies (the “Statement”) to govern the investment of the Fund. This Statement summarizes the objectives and policies for the investment of the Fund.

1.4 The Board has approved these objectives and policies after careful consideration of STRS Ohio benefit provisions, and the implications of alternative objectives and policies.

1.5 The Statement has been prepared with five audiences in mind: incumbent, new and prospective Board members; STRS Ohio investment staff; STRS Ohio active and retired members; Ohio General Assembly and Governor; and agents engaged by the Board to manage and administer the Fund.

1.6 The Board regularly, but in no event less than annually, will assess the continued suitability of this Statement, initiate change as necessary, and update this Statement accordingly.

1.7 The Board may authorize its administrative officers and committees to act for it in accord with its policies (ORC Sections 3307.04 and 3307.15). The Board, no less frequently than annually, adopts a resolution delegating to the Executive Director and the Deputy Executive Director, Investments, the authority to acquire, dispose, operate and manage the Fund, subject to the Board’s policies and to subsequent approval by the Board. Consequently, the Executive Director, the Deputy Executive Director, Investments, and the investment staff are responsible for preparing and maintaining numerous supporting management documents that govern the implementation of Board policies, including, but not limited to, individual investment manager mandates and guidelines, agent agreements and limited partnership documents.

1.8 In carrying out the operation and management of STRS Ohio, the Board, the Executive Director, his investment staff and others that are considered fiduciaries as defined in ORC Section 3307.01(K) are subject to various fiduciary responsibilities in ORC Chapter 3307, including, those found in ORC Sections 3307.15, 3307.151, 3307.181, and 3307.18. This Statement incorporates, and is subject to, all of provisions of ORC Chapter 3307.

1.9 The Board acknowledges its responsibilities under ORC Chapter 3307 and to the extent that this Statement is inconsistent with ORC Chapter 3307, Chapter 3307 shall control.

1.95 The Board approved this Statement on May 15, 2009.

2.0 Investment Objective

2.1 Subject to the Ohio Revised Code, the investment objectives for the total fund are:

(a) to earn, over moving twenty-year periods, an annualized *return* that equals or exceeds the *actuarial rate of return* (ARR), approved by the Board to value STRS Ohio liabilities. The current actuarial rate of return is 8.0%,

(b) to earn a rate of return that enables the System to meet pension liabilities and fulfill minimum funding requirements,

(c) to earn a rate of return that equals or exceeds the System's long term policy index with an acceptable level of risk, and;

(d) maintain sufficient liquidity to satisfy cash flow needs.

2.2 The Board believes, based on the assumptions in this Statement, that the investment policies summarized in this Statement will achieve this long-term actuarial objective, at an acceptable level of *risk.* The Board evaluates risk in terms of the probability of not achieving the ARR over a twenty-year time horizon.

3.0 Key Document Policy

To assist the Board and the Investment staff, the following key documents will be produced or reviewed according to the schedule in Exhibit 1.

Exhibit 1: Key Document Schedule

Key Document	Document Source	Review Schedule
Trustee Summary Report	Board Consultant	Quarterly
Three Level Performance Report	Board Consultant	Semi-Annual
Statement of Investment Objectives and Policy/Fund Governance	STRS Ohio Investment Department/Reviewed by Board Consultant	Annual
Annual Plan (Incl. Risk Budget)	STRS Ohio Investment Staff/Reviewed by Board Consultant	Annual
Actuarial Study	Actuary/STRS Ohio Finance Dept.	Annual
Asset/Liability Study	STRS Ohio Investment Staff/STRS Ohio Senior Staff/Board Consultant /STRS Ohio Board	Every 3-5 years

4.0 Asset Mix Policy, Risk Diversification and Return Expectations

4.1 After careful consideration of the investment objectives, *liability* structure, *funded status* and liquidity needs of STRS Ohio, and the return, risk and *risk-diversifying* characteristics of different *asset classes*, the Board approved the *asset mix policy* presented in Exhibit 2. The exhibit also summarizes the Board's return expectations for the asset mix policy and active management.

4.2 Sixty-Nine percent of the Fund is targeted for investment in *equities*, inclusive of *alternative* investments. Equity investments have provided the highest returns over long time periods, but can produce low and even negative returns over shorter periods.

4.3 The risk of low returns over shorter time periods makes 100% equity policies unsuitable for most pension funds, including STRS Ohio. By investing across multiple equity asset classes, and in lower return but less risky *fixed-income* and *real estate*, the Board is managing and diversifying total fund risk.

4.4 Forecasts of capital market and active management returns undertaken by the Board's asset management consultant indicate that the Board's investment policy summarized in Exhibit 2 has an expected twenty-year annualized return of 8.1%. The expected 8.1% annualized return is 0.1% above the Board-approved 8.0% actuarial rate of return.

Exhibit 2: Asset Mix Policy and Return Expectations for STRS Ohio Total Fund

Asset Class	Target Allocation (%)	Rebalancing Range (%)	Expected 20-Year Policy Returns[1,2] (%)	Expected 5-Year Management Net Returns[3] (%)	Expected Total Return (%)
Equity					
Domestic	39	30-50	8.5	0.25	8.75
International	23	18-30	8.8	1.00	9.8
Alternatives	7	3-13	10.35		10.35
-Private Equity	5	3-8	11.5		11.5
-Opportunistic/Diversified	2[6]	0-5	7.5		7.5
Fixed Income	20	15-30	4.8	0.35	5.15
Real Estate	10	6-13	6.5	1.00	7.5
Liquidity Reserve	1	0-5	3.4		3.4
Total Fund[5]	100		7.7	0.40	8.1

1. Based on the 2009 Asset Allocation Study.
2. The 20 year return forecast is 8.1% per year.
3. Individual asset classes are gross value added; the total fund is net value added.
4. The target allocation percentage will be effective as of July 1, 2009.
5. The Total Fund benchmark is a blend of the asset class benchmarks based on the Total Fund's target allocation for the respective asset classes. Effective July 1, 2009 the Total Fund benchmark will be calculated using 20% Barclays Capital Universal Index, 39% Russell 3000, 23% International Blended Benchmark, 10% Real Estate Blended Benchmark, 7% Alternative Investment actual return, and 1% 3-month Treasury Bill Index.
6. Opportunistic/Diversified target weight is scheduled to increase 1% per year until a max 5% target weight is obtained effective July 1, 2012.

4.5 From the 2009 Asset Allocation Study the 7.7% expected asset mix policy return was developed with reference to the observed long-term relationships among major asset classes. The Board believes this return expectation is reasonable, but recognizes that the actual twenty year asset mix policy return can deviate significantly from this expectation – both positively and negatively.

4.6 Fund assets are invested using a combination of passive and active management strategies. Active management of public market securities and real estate assets is expected to earn net 0.40% per annum of additional returns over moving five-year periods. The Board recognizes that unsuccessful active management can reduce total fund returns.

4.7 Investment objectives and guidelines for individual asset classes have been approved by the Board, and are summarized below.

4.8 Liquidity reserves are kept at a minimum level, but sufficient to cover the short-term cash flow needs. STRS investment staff may utilize a *derivative overlay* to maintain the level at 1%.

4.9 The Board reviews at least annually its expectations for asset class and active management performance, and assesses how the updated expectations affect the probability that the Fund will achieve the established investment objectives.

5.0 Rebalancing

5.1 Exposures to selected asset classes are actively managed within the rebalancing ranges specified in Exhibit 2. Rebalancing ensures that the Fund's actual asset allocation remains close to the target asset mix policy.

5.2 The Fund's actual asset allocation is monitored at least monthly relative to established asset allocation policy targets and ranges. The timing and magnitude of rebalancing are decided with due consideration to the liquidity of the investments and the associated transaction costs.

5.3 In its Annual Investment Plan prepared for the Board, staff explains how they are managing asset class exposures based on short- and intermediate-term capital forecasts.

5.4 The impact of rebalancing decisions on total fund returns is included in investment performance reports to the Board.

6.0 **Passive and Active Management within Risk Budgets**

6.1 STRS investment staff has been delegated the responsibility for managing the Fund's exposure to passive and active investment strategies, subject to the constraint that active risk does not exceed Board-approved target *risk budgets* for the total fund and individual asset classes.

6.2 The Board has approved a target risk budget of .60% to 1.20%, with a working range of .20% to 1.60%, annualized for active management for the total fund. In exchange for assuming this level of active risk, the Board expects active management to add net 0.40% of annualized excess return over moving five-year periods.

6.3 The Board realizes that actual management returns will likely be above or below the net 0.40% target over any five-year moving period, and therefore will evaluate the success of STRS active management program within this context. The Board recognizes that any amount of management return in excess of the associated investment costs improves the security of STRS plan members.

6.4 Passive management uses low cost *index funds* to access the return streams available from the world's capital markets. Indexed funds control costs, are useful tools for evaluating active management strategies, capture exposure to the more *efficient markets* and facilitate rebalancing to the policy asset mix.

6.5 Active management tries to earn higher returns than those available from index funds by making value-adding security selection and asset mix timing decisions. Unsuccessful active management earns below index fund returns.

6.6 Because there are no index fund products for real estate and alternative investments, these asset classes must be actively managed.

6.7 Aggregate short sale positions for all asset classes may not exceed 3% of total fund assets.

7.0 Global Equities - Domestic

7.1 Domestic equity is being managed relative to a Board-approved risk budget range of .20% to 1.50%, and is expected to earn at least 0.25% of annualized excess return above the Russell 3000 Index over moving five-year periods.

7.2 Key elements of the strategy:

(a) The portfolio's active management adds value primarily through security selection. Sector tilts by style, economic sectors or *market capitalization* are managed in accordance with the risk budget for domestic equities.

(b) The portfolio utilizes a variety of portfolio management approaches including quantitative and fundamental techniques to diversify the source of excess return.

(c) The portfolio utilizes a combination of internal and external management, utilizing multiple internal portfolio managers and multiple external manager firms to improve the likelihood of achieving excess returns, to diversify risk and to control costs.

7.3 *Short Sales* may be used in the management of STRS domestic equity portfolios, but may not exceed 10% of the value of the asset class.

8.0 Global Equities - International

8.1 International equity is being managed relative to a Board-approved risk budget range of 1.0% to 2.50%, and is expected to earn at least 1.0% of annualized excess return above a blended benchmark of 80% MSCI World ex-US (50% hedged) and 20% MSCI Emerging Market Free Index over moving five-year periods.

8.2 Key elements of the strategy:

(a) The portfolio emphasizes fundamental management approaches and exposures to security selection and country allocation decisions. These decisions have been shown to be the principal sources of the excess return in international equity portfolios. Managers have the ability to add value through currency management.

(b) Aggregate exposures to countries, currencies, equity styles and market capitalization are monitored and managed relative to their benchmark exposures.

(c) The portfolio utilizes a combination of internal and external management, with multiple internal portfolio managers and multiple external manager firms to improve the likelihood of achieving excess returns, to diversify risk and to control costs.

8.3 Short Sales may be used in the management of STRS international equity portfolios, but may not exceed 10% of the value of the asset class.

9.0 Fixed Income

9.1 Fixed income is being managed relative to a Board-approved risk budget range of 0.1% to 1.50%, and is expected to earn at least 0.35% of annualized excess returns above the Barclays Capital Universal Index over moving five-year periods.

9.2 All of fixed income is actively managed because active management is generally low cost and market opportunities exist for skilled managers to generate excess returns.

9.3 Key elements of the strategy:

(a) The portfolio will primarily be managed internally, with multiple external managers utilized in specialized segments of the market such as high yield and emerging market debt.

(b) The portfolio will emphasize issue selection, *credit* analysis, sector allocations and *duration* management.

(c) Aggregate exposures to duration, credit and sectors are monitored and managed relative to corresponding exposures in the asset class benchmark.

9.4 Short Sales may be used in the management of STRS fixed income portfolios, but may not exceed 10% of the value of the asset class.

10.0 Real Estate

10.1 Real estate investments are being managed relative to a Board-approved risk budget range of 2.00% to 7.00%, and are expected to earn at least 1.00% of annualized excess returns above a composite benchmark over moving five year periods. The Real Estate benchmark is 85% NCREIF Property Index, and 15% Wilshire Real Estate Investment Trust Index.

10.2 Key elements of the strategy:

(a) Real Estate is 100% actively managed because index funds replicating the real estate broad market are not available. The portfolio is primarily managed internally. External Managers are utilized primarily for specialized segments of the market.

(b) *Direct property investments* represent most of the real estate portfolio. Risk is diversified by investing across major property types and geographic areas.

(c) Leverage of up to and including 50%, in aggregate, is permitted for internally managed assets (excluding REITs).

(d) Publicly traded real estate investment trusts (*REITs*) are targeted at 15% of the real estate portfolio to enhance liquidity, diversification and excess returns.

(e) *Non-core real estate* investments are limited to 20% of the real estate portfolio. Investment strategies will be characterized as "opportunistic" based on the market conditions prevailing at the time of investment.

10.3 Short Sales may be used in the management of REITs, but may not exceed 10% of the value of the asset class.

11.0 Alternative Investments (Private Equity & Opportunistic/Diversified)

11.1 Alternative Investments involve separate allocations to Private Equity and Opportunistic/Diversified investments.

11.2 Private Equity investments are being managed with the objective of earning at least 3% net of fees above domestic public equity markets over very long time horizons, typically moving 10-year periods. Private Equity investments are traded infrequently and, therefore, risk budget concepts are not applicable.

11.3 Key elements of the Private Equity strategy:

(a) Private Equity investments are 100% actively managed because index funds are not available.

(b) Private Equity risk is diversified by investing across different types of investments including but not limited to venture capital, leverage buyouts, mezzanine debt, sector and international funds.

(c) Private equity risk is also diversified by investing across vintage years, industry sectors, investment size, development stage and geography.

(d) Private equity investments are managed by general partners with good deal flow, specialized areas of expertise, established or promising net of fees track records, and fully disclosed and verifiable management procedures.

11.4 Opportunistic/Diversified investments are being managed with the objective of earning domestic public equity-like returns (approximately 1% net of fees below domestic public equity markets) over very long time horizons, typically moving 10-year periods, but with the goal of downside protection during equity bear markets. Investments in this category can be liquid or illiquid and, therefore, risk budget concepts are not applicable.

11.5 Key elements of the Opportunistic/Diversified strategy:

(a) Opportunistic/Diversified investments are tactical in nature and typically are actively managed because index funds would not be available.

(b) Downside protection during equity bear markets can be achieved and asset class risk is diversified by investing across different types of Opportunistic/ Diversified investments primarily modeled on hedge funds, commodities, and infrastructure, but can include current “opportunistic” investments such as commercial mortgage-backed securities, non-agency mortgages, and distressed debt, and may include low volatility equity, defensive equity, emerging market equities, master limited partnerships, listed private equity, closed-end funds, diversified alpha/beta strategies, volatility strategies, local currency emerging market debt, bank loans, agricultural investing, managed futures, natural resources, green, and energy investing, micro-finance institutions, etc.

(c) Opportunistic/Diversified investments may be made directly, through specialist managers, or through fund-of-funds.

12.0 Derivatives

12.1 *Derivatives* may be used in the management of STRS internal and external liquidity reserves, fixed income, equity and real estate portfolios. Derivatives are typically, but not exclusively, *futures contracts, equity swaps, credit default swaps, option contracts* and option contracts on futures for market indexes. Options on individual securities, baskets of securities and equity-linked notes, and shorting for positioning purposes are further examples. Derivatives are both exchange traded and traded over the counter.

12.2 Derivative exposures must be of a hedging or positioning nature. As a percentage of Fund assets, the underlying exposure of all positioning derivatives will not exceed:

(a) 5% for fixed income investments;

(b) 10% for domestic equity investments;

(c) 10% for international equity investments; and,

(d) 1% for real estate investments.

Hedging derivatives will not be included in the limits above, but must be footnoted.

12.3 Any use of leverage will adhere to asset allocation restrictions and asset class active management risk range constraints.

13.0 Proxy Voting

13.1 Common stock proxies are valuable and should be voted in the best interest of STRS active and retired members.

13.2 The Board shall maintain stock proxy voting policies and has directed staff and the proxy voting agents to use these policies as guidelines for voting common stock proxies held by the Fund.

14.0 Ohio Investments

14.1 The Board will give due consideration to investments that enhance the general welfare of the state and its citizens provided that assets are invested in the best interest of STRS active and retired members. Preference will be given to Ohio investments offering competitive returns at risk levels comparable to similar investments currently available to the Board.

14.2 STRS investment staff shall maintain and implement an Ohio Investment Plan. The plan shall set forth procedures to assure that a special effort will be made by the investment staff to examine and evaluate all legal investment opportunities in the state and, where policy criteria are satisfied, to acquire such investments.

15.0 Broker-Dealers

15.1 Purchases and sales of publicly traded securities shall be executed with broker-dealers from a list reviewed by the Board. In those rare situations where best execution cannot be achieved through a broker-dealer on the list, the Deputy Executive Director, Investments, may approve the use of a broker-dealer not on the list.

15.2 Selection shall be based on an evaluation by the investment staff as to financial soundness, underwriting capabilities, research services, execution capabilities and other factors required by the staff to fulfill its assigned investment responsibilities.

15.3 Specific transactions will be directed to the broker on that list most capable of providing brokerage services necessary to obtain both the best available price and the most favorable execution.

15.4 The Board shall give equal consideration to smaller Ohio-headquartered broker-dealers or smaller broker-dealers with at least one Ohio office and broker-dealers owned and controlled by minorities and/or women, provided the assets are transacted in the best interest of STRS Ohio members.

15.5 The Board has a goal to increase the use of Ohio-qualified broker-dealers for the execution of domestic equity and fixed-income securities transactions, when the services that Ohio-qualified broker-dealers provide are equal in quality, cost, scope and execution capabilities to all broker-dealers approved to transact securities transactions on behalf of the Board.

15.6 Each firm listed shall file with the Board on an annual basis such evidence of financial responsibility as required by the Board. This information shall include, but not be limited to, an audited financial statement.

15.7 When stocks are purchased during underwriting, allocations may be made to dealers not on the approved list provided the managing underwriter is so listed.

15.8 When entering into real estate transactions, the Board shall give equal consideration to Ohio firms providing associated professional services, minority-owned and controlled firms, and firms owned and controlled by women.

16.0 Securities Lending

The Board may operate a securities lending program to enhance the income of the Fund. The program must be operated by a bank trustee who follows the custodial requirements of the Treasurer of State and each security lent must be fully collateralized. Results of the program must be reported to the board annually.

17.0 Securities Litigation

Involvement in securities litigation is an important responsibility for institutional investors with major public market exposure. The Board shall maintain a policy to determine the appropriate action to be taken when class action litigation is initiated against a company that generates a significant loss for the Board during the class period.

18.0 Security Valuation

Valuation of investments shall be the total of:

(a) The primary closing price on the principal registered stock exchange for all common and preferred stocks so listed.

(b) The NASDAQ Official Closing Price (NOCP) as reflected by NASDAQ for common and preferred stocks not listed on a registered stock exchange.

(c) The current value as determined by a qualified independent service for all bonds, notes and certificates of indebtedness.

(d) Amortized cost for commercial paper, certificates of deposit, repurchase agreements and other short-term investments with a maturity of 270 or fewer days.

(e) Real estate valued through a combination of independent appraisals and manager valuations. Methodology underlying internal valuations will be reviewed by the real estate consultant. REIT shares are valued at primary closing prices on the principal registered stock exchange.

(f) The most recent manager valuations for alternative investments updated to include subsequent capital activity.

(g) International investments are valued by the sub-custodian using relevant closing market prices and exchange rates.

19.0 Performance Monitoring and Evaluation

19.1 The Board and its agents use a variety of compliance, verification and performance measurement tools to monitor, measure and evaluate how well STRS Ohio assets are being managed. Monitoring, reporting and evaluation frequencies range from hourly, to daily, weekly, monthly, quarterly and annually.

19.2 The Board has developed a performance monitoring and evaluation system that answers two fundamental fiduciary questions:

(a) Are the assets being prudently managed? More specifically, are assets being managed in accordance with established laws, policies and procedures, and are individual investment managers in compliance with their mandates?

(b) Are the assets being profitably managed? More specifically, has performance affected benefit security, has capital market risk been rewarded and has active management risk been rewarded?

19.3 If there is a deviation from Board policies, STRS investment staff is required to provide the Board with a report explaining how the deviation was discovered, the reasons for the deviation, the impact on Fund performance, if any, and steps taken to mitigate future occurrences.

19.4 Exhibit 3 is one of many reports used by the Board to monitor and evaluate performance of the total fund. Panel one indicates whether the total fund return exceeded the 8.0% actuarial rate of return. Panel two indicates whether the Fund was rewarded for investing in higher return but more risky equity investments. Panel three indicates whether active management added or subtracted returns.

Exhibit 3: Example Total Fund Trustee Summary Report, as of June 30, 2008.

Experienced Returns	Annualized Rates of Return			
	1 Year	3 Years	5 Years	10 Years
Have returns affected funded ratio?				
1. Total fund return	-5.44%	9.09%	11.40%	6.52%
2. Actuarial discount rate	8.00%	8.00%	8.00%	7.82%
3. Out/under-performance (1-2)	-13.44%	1.09%	3.40%	-1.30%
Has plan been rewarded for capital market risk?				
4. Total fund policy return	-5.79%	8.11%	10.38%	6.19%
5. Minimum risk/high opportunity cost policy of 91-Day T-Bills	2.90%	4.02%	3.06%	3.40%
6. Impact of asset mix policy (4-5)	-8.69%	4.09%	7.32%	2.79%
Has plan been rewarded for active management risk?				
7. Active management effect (1-4)	0.35%	0.98%	1.02%	0.33%
8. Net active management return estimate	0.24%	0.87%	0.90%	0.22%

19.5 Additional reports provide the Board with a multi-level view of investment activities at different levels and over different time horizons. These include:

Performance of the total fund;

Performance of individual asset class strategies;

Performance of internal and externally managed portfolios; and,

Performance of individual external managers.

Glossary

Actuarial Rate of Return (ARR): The interest rate used to calculate the present value of a defined benefit plan's future obligations and to determine the size of contribution to the plan.
Private Equity: Investments in usually high-risk companies whose securities are not publicly traded. Investments are very illiquid. Successful alternative equity investments can earn returns that are significantly higher than those available from publicly traded securities.
Asset Class: A collection of securities that have conceptually similar claims on income streams and have returns that are highly correlated with each other. Most frequently referenced publicly traded asset classes include domestic equities, fixed income and cash.
Asset mix policy: A pension fund's long-term planned exposure to major asset classes, usually expressed in percentages. For example, many US pension funds have an asset mix policy of 60% equities and 40% fixed-income. Empirical studies have confirmed that asset mix policy is the primary determinate of portfolio performance.
Benchmark: A standard by which investment performance can be measured and evaluated. For example, the performance of domestic equity managers is often measured and evaluated relative to the benchmark performance of the Russell 3000 Index.
Credit: The measure of an organization's ability to re-pay borrowed money. Used most often in managing fixed income portfolios. Organizations with the highest credit rating - those most likely to re-pay money they have borrowed - are assigned a AAA credit rating.
Derivatives: A financial obligation that derives its value from the value of one or more other assets, such as a bond or basket of stocks. These other assets are referred to as the "underlying assets or underlying exposures".
Derivative Overlay: Combining collateral with derivative instruments to produce returns comparable to the capital markets.
Direct Property Investments: Real estate investment strategies in which the investor is the direct owner of the real estate by holding the deed to the real estate property, which could be land and/or buildings.
Distressed Debt: A private equity investment strategy that involves purchasing discounted bonds of a financially distressed firm. Distressed debt investors frequently convert their holdings into equity and become actively involved with the management of the distressed firm.
Duration: A financial measure used by investors to estimate the price sensitivity of a fixed-income security to a change in interest rates. For example, if interest rates increase by one percentage point, a bond with a 5-year duration will decline in price by 5 percent.
Efficient Markets: A market in which security prices rapidly reflect all information about securities and, by implication, active managers find it more difficult to pick stocks that

consistently beat the performance of an index fund.
Equities: Investments that represent ownership in a company and therefore a proportional share of company profits. For example, owning common shares of General Motors Corporation is an equity investment.
Fixed-Income: Debt obligations of corporations and governments that specify how money previously borrowed is to be repaid. Typically, money is repaid by a series of semi-annual interest payments of fixed amounts, and final repayment of principal.
Funded Status: A comparison of plan assets with the plan liability (e.g. the actuarial accrued liability (AAL)). When fund assets are greater than the AAL, the plan is overfunded. If fund assets are less than the AAL, the plan is underfunded and the state has a net liability position with respect to its pension plan.
Futures Contract: A standardized agreement to purchase or sell a defined amount of a particular security or commodity at a fixed price on a set future date.
Hedged: A term applied to a portfolio of non-domestic stocks or bonds that is unaffected by changes in the relative value of the domestic and foreign currencies. Forward currency contracts are typically used to hedge a portfolio against currency risk.
Index Fund: A portfolio management strategy that seeks to match the composition and performance of a selected market index, such as the Russell 1000.
Leverage Buyouts (LBO): The acquisition of a firm or business unit, typically in a mature industry, with a considerable amount of debt. The debt is then repaid according to a strict schedule that absorbs most of the firm's cash flow.
Liability: A claim on assets by individuals or companies. In a pension context, liabilities represent the claim on fund assets by active and retired members of the pension plan.
Market Capitalization: The value of a corporation as determined by multiplying the price of its shares by the number of shares outstanding. Investors often use market capitalization as an indicator of portfolio risk or volatility. In general, smaller capitalized companies are more volatile or risky than larger capitalized companies.
Mezzanine Debt: Either a private equity financing undertaken shortly before an initial public offering, or an investment that employs subordinated debt that has fewer privileges than bank debt but more than equity and often has attached warrants.
Non-core real estate: A real estate investment style best described as opportunistic, which has higher risk but higher expected returns. Non-core real estate may be very illiquid, not currently income-producing, distressed purchases or highly leveraged. Examples of non-core real estate are international real estate funds, opportunity real estate funds and real estate projects at the development stage of the investment.
Option Contract: A standardized agreement that conveys the right, but not the obligation, to buy or sell a specific security or commodity at a stipulated price and within a stated time period.
Real Estate: Direct or indirect investments in land and/or buildings.
Real Estate Investment Trusts (REIT): A real estate portfolio managed by an investment

company for the benefit of the trust unit holders. Most REIT units are publicly traded.
Return: The gain or loss in value of an investment over a given period to time expressed as a percentage of the original amount invested. For example, an initial investment of $100 that grows to $105 over one year has earned a 5% return.
Risk: In its most general usage, risk refers to the possibility of loss or injury. Within the world of fund management, risk usually refers to either (a) the possibility of the loss of client assets, relative to an expected outcome, or (b) injury to a fiduciary's reputation because of imprudent decision-making. Various statistical tools and techniques are used to manage the probability of losing client assets, relative to an expected outcome. The probability of injury to fiduciary reputations is managed by establishing, documenting, implementing and enforcing policies and procedures that demonstrate prudent decision-making, even if the decisions resulted in the loss of client assets.
Risk Budget: A constraint imposed on an investment manager to limit the extent to which an actively managed portfolio can lose value relative to a passively managed portfolio due to the active manager's decisions, at a given confidence level. For example, a 4% annualized risk budget indicates to an active manager that portfolio losses attributable to his/her active management decisions should not exceed 4% in more than three years out of twenty. A more frequent pattern of losses in excess of 4% suggests the manager may be taking more risk than permitted in his/her mandate. A risk budget constraint is also known as a "value-at-risk" constraint.
Risk-diversifying: Reducing risk without reducing expected returns by combining assets with returns that move in opposite directions over a given time period thereby reducing the total portfolio risk. A decline in the price of one asset is offset by the increase in the price of another asset in the portfolio. In laypersons terms, this is often described as putting your eggs into more than one basket.
Short Sales: Short sale positions generally involve borrowing and then subsequently selling a security. Short sellers expect to buy the "shorted" security back in the future at a lower price, return the borrowed security, and profit from the difference between the sale and the purchase price. Short sales are transactions which result in positive performance if the security sold "short" declines in price.
Unhedged: A term applied to a portfolio of non-domestic stocks or bonds that is affected by the changes in the value of domestic and foreign currencies.
Venture Capital: Independently managed, dedicated pools of capital that focus on equity or equity-linked investments in privately held, high growth companies. Outside of the United States, the term venture capital is used as a synonym for all types of alternative or private equity.
Vintage Year: The group of funds whose first closing occurred in the same year. For example, venture capital funds of vintage year 1995 were closed to additional investors in 1995.

State Teachers Retirement
System of Ohio

Statement
of
Fund Governance

Contents

Glossary of Selected Terms

Terms highlighted in *italics* are explained in the glossary.

Purpose

1.0 This Statement of Fund Governance (the "Statement") summarizes the governance structure established by the State Teachers Retirement Board of Ohio (the "Board") to ensure the prudent, effective and efficient management of the assets of the State Teachers Retirement System of Ohio.

1.1 The fund governance structure was approved by the Board after careful consideration of alternative approaches to governing a very large and growing pension fund within an increasingly complex financial and investment environment.

1.2 The Statement has been prepared with five audiences in mind: incumbent, new and prospective Board members; STRS investment staff; STRS active and retired members; Ohio General Assembly and Governor; and agents engaged by the Board to manage, administer or advise on STRS assets.

1.3 The Statement summarizes more detailed documents policy and procedure documents prepared and maintained by STRS investment staff, and numerous other documents that govern the day-to-day management of STRS assets.

1.4 The Board regularly assesses the continued suitability of the STRS fund governance structure, initiates change as necessary, and updates this Statement accordingly.

1.5 The Board may authorize its administrative officers and committees to act for it in accord with its policies (ORC Sections 3307.04 and 3307.15). The Board, no less frequently than annually, adopts a resolution delegating to the Executive Director and the Deputy Executive Director, Investments, the authority to acquire, dispose, operate and manage the Fund, subject to the Board's policies and to subsequent approval by the Board.

1.6 In carrying out the operation and management of STRS, the Board, the Executive Director, his investment staff and others that are considered fiduciaries as defined in ORC Section 3307.01(K) are subject to various fiduciary responsibilities in ORC Chapter 3307, including, those found in ORC Sections 3307.15, 3307.151, 3307.181, and 3307.18. This Statement incorporates, and is subject to, all provisions of ORC Chapter 3307.

1.7 The Board acknowledges its responsibilities under ORC Chapter 3307 and to the extent that this Statement is inconsistent with ORC Chapter 3307, Chapter 3307 shall control.

1.8 The Board approved this Statement on May 15, 2009.

2.0 Governance Principles

2.1 Three principles guided the Board's development of the STRS fund governance structure:

(a) As STRS *governing fiduciary*, the Board is ultimately accountable for all investment decisions. Section 3307.15 of the Ohio Revised Code (the "Code") vests the investment function in the Board and requires the Board to "…adopt in regular meetings, policies, objectives and criteria for the operation of the investment program…" *Section 3307.15 of the Code* sets forth the fiduciary responsibility of the Board in discharging its duties with respect to the fund.

(b) To ensure STRS assets are prudently, profitably, and efficiently managed on a day-to-day basis, the Board needs to delegate the management and implementation of Board investment policies to qualified *managing and operating fiduciaries*. Sections 3307.04 and 3307.15 of the Code empower the Board to authorize its committees and administrative officers to act for it in accord with Board policies. The fiduciary responsibility the Board delegates in discharging their duties with respect to the fund is specified in Section 3307.15.

(c) To ensure effective oversight of delegates, the Board requires informative and timely performance reports that reveal if managing and operating fiduciaries have complied with established policies, and indicate how assets under their care have performed relative to Board approved investment objectives.

3.0 Investment Decisions Retained by the Board

3.1 The Board approves the following investment policies:

(a) Statement of Investment Objectives and Policy, which includes the following:

(i) Total fund *risk* and *return* objectives;

(ii) Total fund target asset mix policy;

(iii) Total fund asset mix policy rebalancing ranges;

(iv) Active management risk and return objectives at the total fund and asset class levels; and;

(v) Performance measurement criteria and evaluation standards;

(b) Proxy voting;

(c) Ohio investments;

(d) Securities lending;

(e) Broker-dealer selection criteria and procedures;

(f) Ohio-qualified investment managers and brokers; and

(g) Securities Litigation.

3.2 Before approving or amending policy decisions, the Board seeks advice, guidance and recommendations from STRS investment staff, Board-retained investment consultants, and other experts or sources as considered prudent by the Board.

4.0 Investment Decisions Delegated to Investment Staff

4.1 The Board, through the Executive Director, has delegated to qualified STRS investment staff the following investment management and implementation decisions

(a) Buying, selling, managing, and monitoring individual securities, real assets, and/or other investment transactions to achieve the total fund and asset class investment objectives approved by the Board;

(b) Retaining, managing, and terminating external investment managers within each asset class as required to achieve the total fund and asset class investment objectives approved by the Board;

(c) Ensure total fund, asset class and individual manager portfolios comply with established parameters and risk levels; and,

(d) Preparing, negotiating and executing external investment manager mandates, guidelines and fee agreements.

4.2 In making these decisions, STRS investment staff seeks the advice, guidance and recommendations of Board-retained investment consultants, external investment managers and other experts and sources as considered prudent by STRS staff.

5.0 Board Oversight

5.1 The Board requires investment staff to prepare and deliver an Annual Investment Plan that explains how STRS assets will be managed in order to achieve the Board-established investment objectives. This provides the Board a focused opportunity to:

(a) Question and comment on staff's investment management plans;

(b) Request additional information and support about staff's investment intentions; and

(c) Express its confidence in the Annual Investment Plan.

5.2 The Board meets at least quarterly to assess how assets are being managed relative to the Annual Investment Plan, to monitor and evaluate investment performance relative to objectives and to address other investment issues as are warranted.

5.3 The Board approves the criteria and standards for monitoring and evaluating the impact different investment decisions have on total fund, asset class, and manager level performance. Performance is monitored and evaluated with respect to risk and return objectives established by the Board.

(a) Investment risks are monitored and evaluated quarterly by comparing total fund and asset class risk characteristics relative to suitable *benchmarks.*

(b) Investment returns are monitored monthly and evaluated quarterly by comparing total fund and asset class returns relative to suitable benchmarks.

5.4 Before approving or amending the criteria for monitoring and evaluating investment decisions, the Board seeks advice, guidance and recommendations from STRS investment staff, Board-retained investment consultants, and other experts and sources as considered prudent by the Board.

Glossary

Benchmark: A standard by which investment performance can be measured and evaluated. For example, the performance of US equity managers is often measured and evaluated relative to the benchmark performance of the Russell 3000 Index.
Governing, managing and operating fiduciaries. Terminology increasingly used in the pension field to distinguish between the governance, management and operations functions in a pension fund. The governance function is mission choice, funding and investment policy decisions, organizational design decisions, the monitoring of organizational effectiveness, and communication of results to stakeholders. This is the domain of governing fiduciaries. Management acts as advisors to the governing fiduciaries, devises strategies for achieving the fund mission and implementing the policies in a cost-effective manner, and organizes and monitors fund operations. This is the domain of managing fiduciaries. Finally, fund operations in the form of portfolio management, risk monitoring, and information system management and reporting are delegated to operating fiduciaries either inside or outside the pension fund organization. See Ambachtsheer, K. P. and D. Don Ezra, *Pension Fund Excellence*, Wiley, 1998, chapter 3.
Section 3307.15 of the Code: The members of the state teachers' retirement board shall be the trustees of the funds created by section 3307.14 of the Revised Code. The board shall have full power to invest the funds. The board and other fiduciaries shall discharge their duties with respect to the funds solely in the interest of the participants and beneficiaries; for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the system; with care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims; and by diversifying the investments of the system so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so.
Return: The gain or loss in value of an investment over a given period of time, expressed as a percentage of the original amount invested. For example, an initial investment of $100 that grows to $105 over one year has earned a 5% return.
Risk: In its most general usage, risk refers to the possibility of loss or injury. Within the world of fund management, risk usually refers to either (a) the possibility of the loss of client assets, relative to an expected outcome, or (b) injury to a fiduciary's reputation because of imprudent decision-making. Various statistical tools and techniques are used to manage the probability of losing client assets, relative to an expected outcome. The probability of injury to fiduciary reputations is managed by establishing, documenting, implementing and enforcing policies and procedures that demonstrate prudent decision-making, even if the decisions resulted in the loss of client assets.