# THE TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA

## *STATEMENT OF INVESTMENT POLICY, OBJECTIVES AND GUIDELINES*

REVISED NOVEMBER 2008

# STATEMENT OF INVESTMENT POLICY

**I.** The Teachers' Retirement System of Oklahoma (TRS) policies and procedures provide for a prudent and systematic investment process on behalf of its members, allowing for reasonable expenses of administration of the Fund, and providing for an orderly means whereby employees may be retired from active service with all pension benefits allowed by Oklahoma statutes. The Standard of Investment for the Board of Trustees in making investments shall be to exercise the judgment, care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like-capacity and familiar with such matters would use in the conduct of an enterprise of a like-character.

**II.** The Board of Trustees diversifies investments to minimize risk. The investment objectives of the Board, as fiduciaries, are long-term rather than short-term. Board policy takes into consideration actuarial assumptions of the retirement program and any unfunded liabilities.

**III.** The Board of Trustees may appoint investment advisors to assist in the investment of the retirement funds. The investment advisors will be subject to the overall investment policies, objectives and guidelines set by the Board of Trustees, and shall have full discretion in the management of those monies of the Fund allocated to them by the Board. The Board of Trustees may direct the TRS Executive Secretary to employ appropriate investment staff to manage those monies not specifically allocated to the investment advisors.

**IV.** The proxy policy statement of the Board of Trustees reflects the fiduciary duty to vote proxies in a manner that most benefits its members. The advisors are to first consider the economic impact on the System, and should the economic impact be neutral, then the advisors should give consideration to acceptable efforts made on behalf of special interests of social conscience. The Board of Trustees retains the right to vote all proxies. Investment advisors will submit their proxy voting policy, to the Board of Trustees for their review and action.

**V.** The Board of Trustees will establish an investment committee pursuant to OAC 715: 10-21-1(4).

The Board of Trustees will establish an investment committee. The investment committee shall be composed of not more than five (5) members of the Board of Trustees appointed by the chairman of the Board of Trustees. The committee shall make recommendations to the full Board on all matters related to the choice of custodians and managers of the assets of the Fund, on the establishment of investment and Fund management policies, objectives and guidelines, and in planning future investment policy. The committee shall have no authority to act on behalf of the Board in any circumstances whatsoever. No recommendation of the committee shall have effect as an action of the Board of Trustees nor take effect without the approval of the Board of Trustees as provided by law.

# INVESTMENT OBJECTIVES, GOALS AND GUIDELINES

The following objectives and guidelines are for use by the investment advisors in connection with the Teachers' Retirement System of Oklahoma. The guidelines and objectives are the basis from which the advisors will operate and upon which they will be evaluated.

## I. GENERAL GUIDELINES

General guidelines to which management of the funds shall adhere include the following:

A. The assets of the Teachers' Retirement System of Oklahoma should be managed with care, judgment, and fiduciary prudence.

B. The advisors are expected to follow an investment approach that reflects their internal policies and guidelines established to define the latitude portfolio advisors would have in developing and managing client portfolios.

C. The Teachers' Retirement System of Oklahoma recognizes that the goals for the returns to be earned on the different classes of capital assets may not be realized. However, the goals are considered to be reasonable given historical experience covering periods with varying economic conditions and investment environments over 50 years and the belief that the United States capital markets will remain viable.

D. The advisors will report to the Board of Trustees monthly, any holdings with values, which have dropped 20 percent from cost. For evaluation purposes, when securities are transferred from one advisor to another, the securities will be placed into the receiving advisors' portfolio at the market value at the time of transfer. When the security exceeds the 20% threshold, the advisor must provide notification to the Board of Trustees within 30 days, providing justification for continuing to hold the security. The advisors will further notify the Board monthly or upon the Board's request for current disposition.

E. The Teachers' Retirement System of Oklahoma will inform the advisors as soon as practical of anticipated additions to or withdrawals from their portfolio. The advisors will be free to determine the most appropriate use for cash additions within the established guidelines and will similarly determine the most appropriate manner in which to raise cash for withdrawals.

F. The investment advisors shall advise each member of the Board of Trustees, the TRS Executive Secretary, and the Board's consultant immediately of any event that is likely to adversely impact, to a significant degree, the management, professionalism, or integrity of the financial position of the firm, including events such as:

- A loss of one or more key people associated with the account;
- A reassignment of responsibilities of key people associated with the account;
- A loss of one or more accounts, which represents more than 5% of the market value of the firm's total assets under management, as measured quarter to quarter;
- The appointment of a new account manager(s) to the account;
- A change in ownership or control of the firm.

## II. CODE OF ETHICS

The Board of Trustees for the Teachers' Retirement System of Oklahoma is responsible for the investment of public monies. This means that, as a fiduciary, the Board is expected to act in a manner, which any unbiased observer would see as objective and free from external influences. The Board must insure that it makes investments that are free from even the appearance of improper influences.

The Board of Trustees has the authority to retain the services of investment advisors and investment consultants. Since these entities may act on behalf of the Board of Trustees, they will adhere to the System's Code of Ethics, in connection with their dealings with the Teachers' Retirement System of Oklahoma.

A. A Trustee or an employee of the Board of Trustees will not, knowingly, receive, directly or indirectly, any money or other valuable thing, for the performance or nonperformance of any act or duty pertaining to their office, other than the compensation allowed by law.

B. A Trustee or an employee of the Board of Trustees will not use their official position or office to obtain direct personal financial gain for themselves, their family, or any business which they or a member of their family is associated unless such use and gain are specifically authorized by law.

C. The Board of Trustees, and any party acting on behalf of the Board will comply with Oklahoma laws governing the responsibilities of a fiduciary.

D. Oklahoma laws state a fiduciary, with respect to the Teachers' Retirement System of Oklahoma, shall not cause the System to engage in a transaction if the fiduciary knows or should know that such transaction constitutes a direct or indirect:

1. Sale or exchange, or leasing of any property from the System to a party in interest for less than adequate consideration or from a party in interest to the System for more than adequate consideration;

2. Lending of money or other extension of credit from the System to a party in interest without the receipt of adequate security and a reasonable rate of interest, or from a party in interest to the System with provision of excessive security or an unreasonably high rate of interest;

3. Furnishing of goods, services or facilities from the System to a party in interest for less than adequate consideration, or from a party in interest to the System for more than adequate consideration; or

4. Transfer to, or use by or for the benefit of, a party in interest of any assets of the System for less than adequate consideration.

E. Oklahoma laws state a fiduciary with respect to the Teachers' Retirement System of Oklahoma shall not:

1. Deal with the assets of the System in the fiduciaries own interest or for the fiduciaries own account;

2. In the fiduciary's individual or any other capacity act in any transaction involving the System on behalf of a party whose interests are adverse to the interests of the System or the interests of its participants or beneficiaries; or

3. Receive any consideration for the fiduciary's own personal account from any party dealing with the System in connection with a transaction involving the assets of the System.

F. Oklahoma laws state a fiduciary with respect to the Teachers' Retirement System of Oklahoma may:

1. Invest all or part of the assets of the System in deposits which bear a reasonable interest rate in a bank or similar financial institution supervised by the United States or a state, if such bank or other institution is a fiduciary of such plan; or

2. Provide any ancillary service by a bank or similar financial institution supervised by the United States or a state, if such bank or other institution is a fiduciary of such plan.

G. Oklahoma laws state a person or a financial institution is a fiduciary with respect to the Teachers' Retirement System of Oklahoma to the extent that the person or the financial institution:

1. Exercises any discretionary authority or discretionary control respecting management of the Teachers' Retirement System of Oklahoma or exercises authority or control respecting management or disposition of the assets of the System;

2. Renders investment advice for a fee or other compensation, direct or indirect, with respect to any monies or other property of the System, or has any authority or responsibility to do so; or

3. Has any discretionary authority or discretionary responsibility in the administration of the System.

## III. PORTFOLIO ASSET ALLOCATION

In order to identify the basis for the asset allocation guidelines outlined herein, the Teachers’ Retirement System of Oklahoma has considered the real return goals for the different classes of capital assets. These goals reflect long-term views, and the System acknowledges the possibility that they may not be realized over short or even intermediate periods.

Real return (i.e., that return in excess of inflation as measured by the Consumer Price Index) goals utilized in reaching the portfolio asset allocation decision are:

| **Capital Assets Class** | **Long-Term Real Return Expectation** |
|---|---|
| Cash Equivalent, Short-Term Investments | 0% to 1/2% |
| Diversified Portfolio of Corporate and Government Bonds | 2% to 4% |
| Diversified Portfolio of Common Stocks | 4% to 7% |
| Total Fund of Common Stocks, and Fixed-Income Instruments | 3 1/2% to 5 1/2% |

The Retirement System's assets will be multi-fund in management: Specialty advisors for the separate asset components; an equity portion comprised of common stocks and convertible securities; a fixed-income portion comprised of bonds and preferred stocks; either as separate components or balanced. Advisors shall hold no more than 5% cash without Board approval. If any advisor desires to increase the cash position above this level for any reason they are to notify the TRS Executive Secretary and Investment

Committee Chairman immediately. Real estate investment portfolio advisors will be limited to only the purchase/sell of publicly traded securities of issuers engaged in real estate business, or marketable securities secured by real estate or interest therein which would include mortgage-backed securities.

## IV. ASSET ALLOCATION TARGETS

The following asset allocation has been adopted by the Board of Trustees of the Teachers' Retirement System of Oklahoma for the purpose of diversifying the investments of the System:

| | |
|---|---|
| Domestic Equity Total | 53% |
| Large Cap | 28% |
| Mid Cap | 15% |
| Small Cap | 10% |
| Domestic Fixed-Income Total<br>International Equity Total | 30%<br>17% |
| Total: | 100% |

The Board of Trustees will review the total portfolio asset allocation on a monthly basis for the purpose of rebalancing the assets when the market value of an asset class deviates ten percent or more from its target allocation.

# INVESTMENT GUIDELINES

The intention of establishing guidelines for investments, which are mutually agreeable to the advisor and to the Teachers' Retirement System of Oklahoma, is to assure that all securities purchased for the System meet fiduciary standards and that adequate diversification of investments is maintained. The System has imposed certain investment restrictions, which, will not be changed without written notice from the System.

## I. GENERAL INVESTMENT GUIDELINES

While these restrictions remain in effect, the System may NOT:

A. Purchase securities on margin, or engage in the short selling of securities not owned.

B. Participate on a joint and several basis in any securities trading account.

C. Purchase securities of any company with a record of less than three (3) years continuous operation (including that of predecessors). "Predecessor firm" defined as a reorganization, a merger, a name change, a public offering, creation of a tracking stock, a spin-off of an internal function, separate operating division or separate holding company, where these developments result in a separately incorporated entity. A written exemption of this guideline may be granted upon request by the advisor and approval by the Board.

D. Invest in companies for the purpose of exercising control or management.

E. Concentrate its investment in a particular industry in excess of 25% of the total value of each advisor's individual TRS portfolio. If any advisor desires to violate the stated 25% maximum, the advisor must have the approval of the Board of Trustees. Each advisor's industry weighting will be compared specifically to each advisor's performance benchmark.

F. Invest in real estate fee simple, but only through investment certificates or other financial instruments. Real estate shall not be held by the System as freehold or leasehold. This policy statement does not exclude the authority of the Board to purchase real estate for home office facilities to be used in administering the System, including land, equipment and office building(s), and providing that the foregoing shall not prevent the Fund from purchasing or selling publicly-traded securities of issuers engaged in any aspect of the real estate business or marketable securities secured by real estate or interest therein which would include mortgage-backed securities.

G. Purchase or sell commodities, commodity contracts, mineral, oil, gas or other mineral explorations or developmental programs. However, the Fund may purchase the securities of companies engaged in the exploration, development, production, refining, transportation and marketing of oil, gas or other minerals. Upon authorization from the Board of Trustees, the Fund may utilize financial futures, but only for purposes of bona fide hedging and in no event for the purpose of speculation.

H. Make loans of money or securities other than (a) through the purchase of securities in accordance with the investment objectives, (b) by lending portfolio securities under circumstances where the borrower of such securities provides cash or cash equivalents as collateral at all times in an amount at least equal to the value of the owned securities and the Fund retains the right to obtain any dividends, interest or other distribution on the securities and any increase in their market value and reserves the right to terminate such arrangement at any time, and (c) by entering into repurchase agreements.

I. Be restricted in realizing net investment gain or losses during any period.

J. Purchase securities, which are denominated in currencies other than that of the United States dollar with the exception of the international (non-U.S.) and global portfolios.

## II. SECURITIES TRANSACTIONS

The Board of Trustees retains the right to direct brokerage commissions. When investment advisors direct commissions on behalf of the Board, the direction will be contingent upon the institution being competitive in both price and execution for the specific transaction.

The Board of Trustees or its employees will only use soft dollar commissions (soft dollars) on fixed income securities which are generated as a result of concessions on fixed price offerings made to brokers on new issues and passed along to the Fund in part or whole. Such soft dollar commissions may be used only for investment related services or products. Soft dollar usage by equity advisors for the benefit of the manager or the Fund is strictly prohibited.

The Board of Trustees may enter into relationships with brokerage firms who will conduct securities transactions at a discount or rebate a portion of commissions to the Fund. No portfolio manager is directed by the Board to trade with any particular brokerage firm. All relationships for commission recapture programs will be directly between the Board of Trustees and brokerage firms on a contract basis. All commission recapture credits will be returned to the Fund and will be treated as an asset of the Fund.

Each advisor will report at least annually to the Board of Trustees their respective commissions recapture program on behalf of the Teachers' System.

## III. DOMESTIC COMMON STOCK GUIDELINES

Unless otherwise indicated, the percentage limitations referred to in the following restrictions will be based upon market values at the time of valuation. When an investment advisor exceeds the thresholds described below, the advisor must provide notification to the Board of Trustees within 30 days, providing justification for continuing to hold the investment. The advisor will further notify the Board quarterly or upon their request for current disposition.

Each portfolio manager of common stocks or convertible securities will do the following with regard to their specific portfolio:

~~A.~~ Not invest more than 5 percent, at cost, or 7 percent, at market, in the securities of any one issuer. Any deviation from this policy statement must have approval from the Board of Trustees.

B. Not invest more than 5 percent of the voting securities or more than 5 percent of the securities of any class of any one issuer. The domestic investment advisor will advise the Board of Trustees of any Securities Exchange Commission 13(d) filings of which a portion of the securities are owned by the Fund.

C. Limit common stock purchases and purchases of American Depository Receipts (ADR's) to those issues on which the advisors' research or portfolio management personnel maintain current opinions. Purchases should be listed on a national exchange (to include NASDAQ). All ADR's will be registered under the Securities Exchange Act of 1934 and will make annual filings of financial statements in conformity with U.S. generally accepted accounting principles (GAAP) or with the local equivalent of GAAP. In the latter case, financial statements will be audited in accordance with U.S. standards and the reports containing footnotes reconciling items to GAAP. All ADR's will be sponsored under a formal agreement with a U.S. depository. It is permissible for the international portfolio to invest in equity securities of non-U.S. issuers.

D. Not restrict investment decisions based upon dividends or earnings for individual securities beyond those implied by the overall emphasis on quality.

E. Domestically, convertible securities are an allowable investment for an investment manager should they request latitude to use convertibles. The manager must demonstrate to the Board that they have significant capabilities in the area and receive Board approval. Furthermore, convertible securities are restricted to the six highest classifications of Moody's and/or Standard & Poor's. The convertible portfolio may utilize 144-A convertible securities, euro convertible securities and B rated securities in proportions not to exceed those of the First Boston Convertibles Index. The Board of Trustees expects that investment managers of convertible securities will be sensitive to the risk of conversion privilege expiration. The manager will inform the Investment Committee of securities held which approach the expiration deadline with 90 days notice.

F. Not purchase securities, which are denominated in currencies other than that of
i. the United States dollar with the exception of international (non-U.S.) and global portfolios.

G. Investment managers may invest in pool funds including Exchange Traded Funds (EFT's), their own sector and their own mutual funds upon board approval. The assets underlying these pooled funds must be consistent with the manager's investment mandates.

## IV. FIXED INCOME GUIDELINES

The following percentage limitations will be calculated based upon total fixed-income market value at the time of valuation. In addition, when an investment advisor exceeds the below-described thresholds, then the advisor must provide notification to the Board of Trustees within 30 days, providing justification for continuing to hold the investment. The advisor will further notify the Board quarterly or upon their request for current disposition.

Each manager of fixed-income securities will do the following with regard to their specific portfolio:

A. Not invest 25 percent or more of the value of the fixed-income portfolio in the securities of issuers principally engaged in the same industry. This restriction does not apply to obligations issued or guaranteed by the United States Government or other sovereign non-U.S. governments within those countries, which comprise the Salomon Non-U.S. World Government Bond Index, or their agencies or instrumentalities.

B. Not invest more than 5 percent in the securities of a single issuer, other than obligations of the United States Government or other sovereign non-U.S. governments within those countries, which comprise the Salomon Non-U.S. World Government Bond Index, or their agencies or instrumentalities.

C. Not own 5 percent or more of the outstanding securities of any issuer, not to exclude purchase of collateralized issues of relatively small size. The domestic investment advisor will advise the Board of Trustees of any Securities Exchange Commission 13(d) filings of which a portion of the securities are owned by the Fund.

D. Not invest in corporate bonds or debentures which at the time of purchase are rated below the highest four (4) classifications established by a rating service recognized by the Comptroller of the Currency. A written exemption to this restriction may be given to an investment advisor by the Board of Trustees. If granted, that exemption will not exceed 20% of individual advisor holdings. If the security drops below the four (4) highest classifications, then the advisor must provide notification to the Board of Trustees within 30 days, providing justification for continuing to hold the security. The advisor will further notify the Board quarterly, or upon their request, of current disposition.

E. Not purchase securities, which are denominated in currencies other than that of the United States Dollar. The Board of Trustees may give a written exemption to this restriction to an investment advisor. If granted, that exemption will not exceed 20% of individual advisor holdings.

F. An advisor granted an exemption to invest in non-U.S. Dollar securities may invest in currency management and derivative securities transactions to manage risk arising from exposure to changing currency fluctuations and to settle trade or repatriate proceeds to the U.S. Dollar.

G. Certain specific "Restricted Securities" may be used as an investment vehicle for fixed income advisors subject to the Board of Trustees approval. These would include Trust Preferred Securities and 144a securities.

H. Investment managers may invest in pool funds including Exchange Traded Funds (ETF's), their own sector and their own mutual funds upon board approval. The assets underlying these pooled funds must be consistent with the manager's investment mandates.

I. An advisor may not hold equity securities unless given a waiver by the System. Fixed Income advisors may not purchase equity securities. If an advisor owns a security that is converted into common shares, it may hold the shares for an indeterminate period of time if holding those shares is a prudent way to maximize the potential recovery or maximize total return. Advisors may not hold more than 5% of their portfolio in common stocks. Further more, if an advisor holds a security that is converted to common shares, they are to notify the TRS Executive Secretary immediately. Should a Fixed Income advisor hold common stock in the portfolio, an exit strategy shall be defined and regular updates will be provided to the TRS.

## V. INTERNATIONAL EQUITY GUIDELINES

The advisor of the international equity funds may:

A. Invest primarily in equity or equity type securities of companies in developed countries excluding the U.S. These equity securities will be listed on a stock exchange or traded in another recognized market and include, but are not limited to, common and preferred stocks, securities convertible or exchangeable into common or preferred stock, REITs, warrants, rights and depository arrangements. The Portfolio may invest in fixed-income securities upon approval of the Board. The Portfolio's investments may be denominated in U.S. Dollars or in non-U.S. currencies. The Portfolio may include securities eligible for resale pursuant to Rule 144A and securities in offerings that are not registered for sale in the U.S. but are listed or quoted in the securities' local markets. Instruments acquired as a result of corporate actions are permitted.

B. Not invest more than 5% of the portfolio, at cost, or 7%, at market in the securities of any one issuer. Any deviation from this policy statement must have approval from the Board of Trustees, or

C. Not invest more than 5% of the outstanding equity of a single issuer.

D. Not concentrate more than 25% of the portfolio's total assets in one or more issuers having their principal business activities in a single industry, or

E. Not invest more than 30% of the portfolio's total assets in one or more issuers in a single country, provided that in the U.K. such limit shall be 35%.

F. At least 80% of the portfolio will be invested in companies located in developed markets as determined by MSCI.

G. Invest in currency management and derivative securities transactions to manage risk arising from exposure to changing currency fluctuations and to settle trades or repatriate proceeds to the U.S. Dollar.

H. Investment managers may invest in pool funds including Exchange Traded Funds (EFT's), their own sector and their own mutual funds upon board approval. The assets underlying these pooled funds must be consistent with the manager's investment mandates.

## VI. CASH EQUIVALENTS GUIDELINES

So long as these restrictions remain in effect, all portfolios will:

A. Not purchase the securities of any issuer other than obligations issued or guaranteed as to principal and interest by the government of the United States, its agencies or instrumentalities, if, as a result:

1. More than 5 percent of the total assets of each portfolio would be invested in securities of such issuer.

2. More than 25 percent of each portfolio's total assets would be invested in the securities of issuers having their principal business

activities in the same industry except for the financial services industry.

B. Limit commercial paper investments to those rated A1 P1 by Standard & Poor's or Moody's Investor Service.

C. So long as these restrictions remain in effect, all international non-U.S. and global funds may:

1. Invest in STIF Funds at Teachers' Retirement System of Oklahoma's, custodian banks and hold cash equivalents denominated in U.S. or foreign currencies, as time deposits in U.S. or foreign banks, obligations of foreign sovereignties or deposits in U.S. or foreign banks, obligations of foreign sovereignties, or Eurodollars, as long as they are denominated in currencies within those countries which comprise the Morgan Stanley Capital International Europe, Australasia and Far East (EAFE) Index plus Canada or the Salomon Non-U.S. World Bond Index or in the U.S. Dollar. Time deposits in U.S. or foreign banks will be limited to those institutions, which have a quality rating within the top three categories of Standard & Poor's and/or Moody's, and have a minimum of $5 billion in assets.

D. A separate investment policy shall be established and approved by the Board of Trustees pertaining to the portfolio's cash position managed and administered by the staff of the System.

## VII. REAL ESTATE INVESTMENT PORTFOLIO GUIDELINES

Real estate investments shall not be held fee simple by the Teachers' Retirement System of Oklahoma, but only through investment certificates or other financial instruments. Real estate shall not be held by the System as freehold or leasehold. This policy statement does not exclude the authority of the Board to purchase real estate for home office facilities to be used in administering the System, including land, equipment and office building(s), and providing that the foregoing shall not prevent the Fund from purchasing or selling publicly-traded securities of issuers engaged in any aspect of the real estate business or marketable securities secured by real estate or interest therein which would include mortgage-backed securities.

## VIII. PERFORMANCE GOALS

To evaluate the progress of the portfolio, investment performance will be reviewed at least quarterly. It is not anticipated that the goals defined below will be satisfied in every single quarter or year. It is, however, expected that performance goals will be met over a full market cycle, normally defined as a three to five year period. Analysis of performance should always be within the context of the prevailing investment environment and the advisors' particular investment style. The investment performance of the Fund will be evaluated relative to the following standards.

A. For The Total Fund

The performance of the total Fund will be compared with the following:

1. Performance Measurement

a. An index developed by combining the returns of the S&P 500 Stock Index, the S&P 400 Mid Cap Index, the Russell 2000 Small Cap Index, the MSCI EAFE International Equity Index, the Lehman Brothers Aggregate Bond Index, and the Salomon Non-US WGBI (Unhedged) Index, as compared to the actual asset allocation.
b. The Consumer Price Index.
c. An absolute annual return over a full market cycle that would compensate the Fund on a risk-adjusted basis.
d. The results of a universe of actively managed funds as measured by a recognized third-party performance evaluator.

2. Goals

a. From active management, the fund is expected to outperform the allocation by at least 1 percent per year, net of fees.
b. The goal of the Fund is to outperform inflation by 3 ½ to 5 ½ percent, net of fees, on an annual basis.
c. Active management is expected to generate for the Fund, returns (over a market cycle) that place it in the top one-third when ranked against comparable funds.

B. Equity Portfolios

The performance of the aggregate domestic equity portion of the Fund will be analyzed against the following:

1. Performance Measurement

a. The S&P 500 to determine the volatility, the degree to which quarterly results reflect the inherent volatility and the degree to which they reflect the selection skills of the advisors.
b. The S&P 500 for corresponding periods.
c. The S&P 500 for up and down segments of the market cycle.

d. A universe of actively managed pension fund equity results as measured by a recognized third-party performance evaluator.

e. The annualized rate of return will be compared with inflation as measured by the Consumer Price Index for the same period to determine the real rate of return earned on common stock investments.

f. An absolute annual return over a full market cycle that would compensate the Fund on a risk-adjusted basis.

2. Goals

a. From active management, the goal of the Fund is to earn at least 1 percent per year, net of fees.

b. The goal of the Fund is to outperform inflation by 4 to 7 percent per year, net of fees.

c. The advisor is expected to generate for TRS monies under management, returns (over a market cycle) that place it in the top one-third when ranked against comparable funds.

d. Index Fund advisors are expected to track the respective index return with a variance of not more than +/- 0.15% per month.

C. Domestic Equity

1. Performance Measurement

a. The S&P 500 Index portfolio's structure and returns will be compared to the S&P 500 Index.

b. The Large Capitalization Growth Equity portfolio will be compared to the Russell 1000 Growth Index and a universe of large capitalization equity portfolios.

c. The Large Capitalization Value Equity portfolio will be compared to the Russell 1000 Value Index and a universe of large capitalization equity portfolios.

d. The Middle Capitalization Equity portfolios will be compared to either the Target Mid Cap 750 Index or the Russell Mid Cap Index. The proper comparative index will be determined by examining each portfolio to determine which index is most appropriate as a gauge of performance. The portfolios will also be compared to a universe of middle capitalization equity portfolios.

e. The Small Capitalization Equity portfolios will be compared to the Russell 2000 Small Stock Index and a universe of small capitalization equity portfolios.

2. Goals

a. The S&P 500 Index portfolio's goal is to track the S&P 500 Index benchmark within 0.05% per year, net of fees.
b. The Large Capitalization Growth Equity portfolio's goal is to outperform the Russell 1000 Growth Index by 1.00% per year, net of fees, and rank in the top one-third of a universe of large capitalization equity portfolios.
d. The Large Capitalization Value Equity portfolio's goal is to outperform the Russell 1000 Value Index by 1.00% per year, net of fees, and rank in the top one-third of a universe of large capitalization equity portfolios.
e. The Middle Capitalization Equity portfolio's goal is to outperform the Target Mid Cap 750 Index or the Russell Mid-Cap Index, by 1.50%, per year, net of fees. The portfolios will also be expected to rank in the top one-third of a universe of middle capitalization equity portfolios.
f. The Small Capitalization Equity portfolio's goal is to outperform the Russell 2000 Small Cap Index by 2.00% per year, net of fees. The portfolios will also be expected to rank in the top one-third of a universe of small capitalization equity portfolios.

D. Fixed-Income Portfolios

The performance of the fixed-income portion of the Fund will be compared with the following:

1. Performance Measurement

a. The Lehman Brothers Aggregate Bond Index.
b. The Consumer Price Index.
c. The results of a representative sample of other non-taxable fixed-income portfolios under the advisors' management.
d. A universe of actively managed pension fund fixed-income results as measured by a recognized third-party performance evaluator.
e. An absolute annual return over a full market cycle that would compensate the Fund on a risk-adjusted basis.

2. Goals

a. The goal of the fixed-income portfolios is to outperform inflation by 2 - 4 percent, net of fees, annually.
b. The advisor is expected to generate for TRS monies under management, returns (over a market cycle) that place it in the top one-third when ranked against comparable funds.

c. The active fixed-income advisors' portfolios are expected to outperform the Lehman Brothers Aggregate Bond Index by 0.50% per year, net of fees.

d. The passive fixed-income advisor's portfolio is expected to track the returns of the Lehman Brothers Aggregate Bond Index with a variance of not more than +/- 0.15% per month, net of fees.

E. International Equity Portfolios

The performance of the international equity portfolios will be compared with the following:

1. Performance Measurement

   a. The return of the Morgan Stanley Capital International Europe, Australasia and the Far East (EAFE) Index.

   b. A universe of actively managed international portfolios as measured by a recognized third-party performance evaluator.

2. Goals

   a. The advisors are expected to generate for TRS monies under management, returns (over a market cycle) that place it in the top one-third when ranked against comparable funds.

   b. The advisors are expected to outperform the EAFE index by 1.50% per year, net of fees (over a market cycle).

F. Cash Equivalent Portfolios

The performance of the cash equivalent portion of the Fund will be compared with the following:

1. The 90-day United States Treasury Bill Index.

2. The Consumer Price Index.

3. Discretionary STIF Index.

## IX. ACCOUNT REVIEWS

The investment advisors will be expected to meet with the Teachers' Retirement System of Oklahoma periodically to review the investment outlook, structure of their portfolios, and past results. A general agenda for these meetings will include:

A. A review of the investment results achieved over the prior month, quarter, year and since inception, in relation to the advisor's investment views and internal policies in effect prior to, and during the period.

B. The advisors current outlook for the economy and capital markets over the next 6-12 months.

C. The internal investment policies that have been adopted in response to these expectations.

D. The appropriateness of the present portfolio under the advisors management, given the expectations and internal policy.

E. A review of the guidelines relative to any restraints that the advisors may represent relative to their ability to fully reflect their expectations or policy.

F. A review of the investment results relative to the longer-term investment performance standards outlined herein including actual results achieved vis-à-vis the performance indices and standards established for the total portfolio and each portfolio segment.

## X. DISTRESSED MORTGAGE FUND

A. Distressed mortgage investments will predominantly target investment opportunities in less liquid segments of the mortgage market. Securities will be primarily based within the United States; however the Distressed Mortgage Fund may make investments located outside of the United States. The Distressed Mortgage Fund is a long-term investment and can be expected to undergo some interim volatility.

B. Investments in the Distressed Mortgage Fund will be governed by the subscription agreement, the Limited Partnership Agreement and other related documents.

C. The Distressed Mortgage Fund targets a total return of 10% to 15%, net of fees, per year over its lifespan. Market conditions, which may change, may affect the Distressed Mortgage Fund's long-term return potential. Performance will be monitored on a quarterly basis until the Distressed Mortgage Fund expires as described in Fund's Private Placement Memorandum.

## XI. OPPORTUNISTIC BOND PORTFOLIO

**A.** Introduction

1. The Board may allocate a portion of the System's investments into a special purpose portfolio to take advantage of temporary market

dislocations. The portfolio should have a risk/return profile that is beneficial to the Board's investment goal. Once market conditions normalize, the portfolio will be wound down at the Board's discretion and the assets reallocated according to the System's long-term target allocation. Credit market improvement will be gauged using the difference in yields between high-yield bonds and similar maturity Treasury bonds. The portfolio will be terminated once the difference between high-yield bonds and similar maturity Treasury bonds reaches four percent (4%). The Board may elect to terminate the program before yield spreads reach four percent (4%). At inception, the Opportunistic Bond Portfolio will compose ten percent (10%) of the System's investment assets. Because this is a temporary allocation, the System's long-term target allocation will not change.

2. The funds will be subjected to the same level of monitoring as the System's other investment portfolios. Performance will be compared to appropriate bond indexes. The performance of the portfolio will also be monitored against the System's total equity allocation. Individual funds may be replaced if necessary. The initial allocation of the Opportunistic Bond Portfolio will be to the following managers:
    1. Loomis Sayles 33.33% allocation
    2. Lord Abbett 33.33% allocation
    3. Mackay Shields 33.33% allocation

**B.** Investment Objective

1. Achieve high current income and the opportunity for capital appreciation through investments mainly in high-yield bonds.

**C.** Style of Investment

1. The portfolio team shall utilize an investment process employing quantitative analysis, fundamental reach, and cyclical analysis. The process is disciplined investing with an emphasis on asset rich companies and credible management teams. The portfolio, in principle, shall utilize an active investment style and maintain investment in securities at a high percentage of the portfolio's assets.

**D.** Benchmark

**1.** The portfolio shall be benchmarked against the Merrill Lynch High Yield Master II Constrained index (HUCO).

**E.** Restrictions

**1.** Purchasing of common stocks for investment shall not be permitted. A manager may not hold equity securities unless given a waiver by the Board of Trustees. If a manager owns a security that is converted into common shares, it may hold the shares for an indeterminate period of time if holding those shares is a prudent way to maximize the potential recovery or maximize total return. Managers may not hold more than five (5%) percent of their portfolio in common stocks. Furthermore, if a manager holds a security that is converted to common shares, they are to notify the TRS Executive Secretary immediately. Should a fixed income manager hold common stock in the portfolio, an exit strategy shall be defined and regular updates will be provided to the TRS.

**2.** Fixed income investment in any single corporate issue, other than U.S. Government and Agency issues, U.S. Government instrumentalities and agency mortgage backed securities shall be limited at time of purchase to no more than five percent (5%) of the fixed income assets under management.

**3.** Investment in securities not rated shall not exceed ten (10%) of the total assets of the portfolio, as determined at the time of the acquisition of any such investment.

**4.** Investments in other funds (including REITSs) not managed or advised by either the Management Company or the Investment Adviser shall not exceed five (5%) of the total assets of the portfolio, at any time, based on the aggregate market value of such investments.

F. Procedure

**1.** Performance of the portfolio shall be measured and reported monthly.

**2.** Unless indicated otherwise, compliance with these investment guidelines will be determined at the time of purchase of the relevant security or instrument. With respect to any requirement with which the portfolio must comply on a continuous basis, the Manager will be allowed a reasonable period to remedy any instance in which the portfolio's assets, due to market appreciation, withdrawals or otherwise, exceed any limitations set forth in these guidelines. In the case of a ratings downgrade, an immediate sale will not be required if the portfolio management team reasonably believes that the sale would diminish the expected total return from the holding or that it is otherwise in the client's best interest to retain the investment. Retention of such investments in the portfolio will not be deemed to constitute a violation of these guidelines.

**G.** Winding Down

**1.** The Board may wind down the Opportunistic Bond Portfolio should its risk/return profile no longer be beneficial to the Board's investment goal. Should the Board find this to be the case, the portfolio will be liquidated and its proceeds used to rebalance the total portfolio. The proceeds may be invested in domestic equity, international equity, fixed income or cash depending on the total portfolio's asset allocation and the state of the investment markets.

## XII. PRIVATE EQUITY GUIDELINES

The OKTRS private equity program (the "Program") is open to all private equity funds that meet certain statutory and policy requirements and guidelines. Specifically, each private equity fund seeking to qualify must be a limited partnership, limited liability company or corporation that:

(1) Is an appropriate investment opportunity with the potential for returns superior to traditional investment opportunities, and not otherwise prohibited by the Program. Investments shall generally fall within the categories defined below:

   a. <u>Buyout and Corporate Restructuring Capital</u>: Investments in leveraged buyouts, management buyouts, equity buyouts, employee buyouts, buy-and-build, other acquisition strategies and restructurings, and related uses of capital

   b. <u>Venture Capital</u>: Investments in relatively small, rapidly growing, private companies in various stages of development

   c. <u>Mezzanine Financing</u>: Unsecured debt or preference shares offering a high return with greater risk than the senior layer of debt but a lower level of risk than the equity piece. It may incorporate equity-based options, such as warrants

   d. <u>Special Situations</u>, which can include:

      i. *Distressed Securities*: Debt or equity securities investments in troubled companies, under the assumption that the securities will appreciate in value following a restructuring of the company's obligations. This includes, but is not limited to, investments in companies that are insolvent or unable to pay their debts as they come due. This may include companies subject to the Bankruptcy Reform Act, specifically Chapter 7 (Liquidation) and Chapter 11 (Reorganization), and companies undergoing restructurings outside of Bankruptcy Court

      ii. *Secondary Funds*: Funds that acquire partnership interests in existing venture and buyout funds

(2) Holds out the prospects for capital appreciation from such investments comparable to similar investments made by other professionally managed private equity funds;

(3) Has a minimum committed capital target of seventy-five million dollars ($75,000,000);

(4) Accepts investments only from accredited investors, as that term is defined in Section 2 of the Federal Securities Act of 1933, as amended, (15 U.S.C. Section 77(b)) and rules and regulations promulgated under that section; and

(5) Has full-time management with at least five years of experience in managing private equity funds.

## I. RISK MITIGATION POLICY

OKTRS understands that private equity investments are generally illiquid and will typically have a long term holding period. When used with publicly traded assets, the asset class helps diversification and reduces risk at the total fund level. Nonetheless, Aldus will take all appropriate measures to reduce risks that are not adequately compensated for by expected return. Such measures include, but are not necessarily limited to, diversification, due diligence, and governance activities.

Diversification reduces risk in the Program's investments and the following types of diversification should be considered, including, but not limited to:

(1) Stage. Investments will be diversified throughout the various financing stages from startup through mezzanine financing to leveraged buyouts and recapitalizations.

(2) Industry Sectors. Investments will be diversified among industry groupings;

(3) Size of Investments. Investments will be diversified among a range of partnerships of varying sizes, but any one investment will not represent an amount greater than 20% of a given partnership;

(4) Geography. Aldus will consider geographical diversification in investment selection;

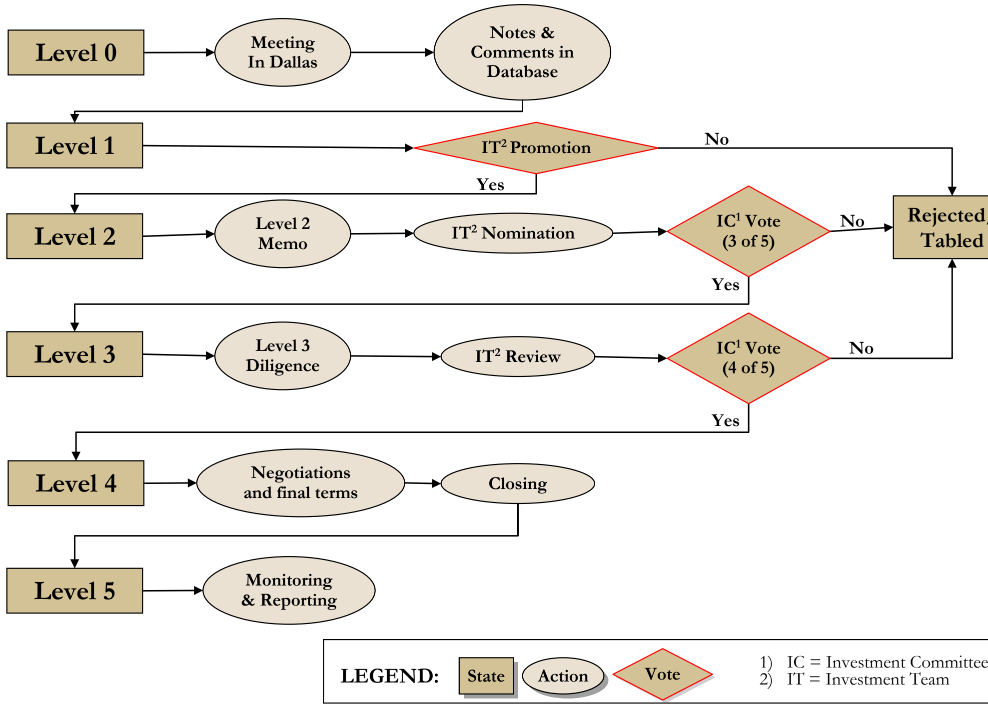
(5) Time. Aldus will endeavor to invest in a consistent manner over time, unless market conditions appear unfavorable.

## II. RETURN OBJECTIVES

On a relative basis, the return objective for Private Equity Investments is 400 bps over the S&P 500 index net of fees, expenses and carried interest. On an absolute basis, the return is assumed to be 14-20%. OKTRS understands that, for a given partnership, return can only be reliably measured over the life of the partnership (typically 10+ years). In addition, the IRR performance in the first few years of a partnership's life is routinely negative due to the J-curve effect. During this period, partnerships are actively making investments and drawing management fees, which results in negative capital account balance.

## III. DUE DILIGENCE & INVESTMENT PROCESS

Aldus will screen available investments and identify those which meet the Program's general strategy, selection criteria and performance goals. The Aldus due diligence and approval process is outlined below:




<u>SELECTION CRITERIA</u>

Generally speaking, Aldus will generally invest with experienced organizations that have managed prior investments or partnerships. Primary emphasis will be on the quality and experience of the investment sponsor or manager.

Additional criteria to be considered will include:

(1) A well-developed investment focus that meets the Program’s objectives and a favorable assessment of the proposed investment’s strategy and market conditions;

(2) Relevant investment experience of partners and key staff, individually and as a team, as well as their stability;

(3) Organizational depth and significant time commitment to the partnership's or project's interests;

(4) Well-structured decision-making and transaction execution processes, including:

a. deal flow and initial analysis of portfolio investments,
b. pricing, selection and negotiation of portfolio investments,
c. financial structuring of portfolio investments,
d. management or oversight of portfolio companies,
e. development of exit strategies;

(5) Consideration of relevant issues, such as conflicts of interest and alignment of interests, among others;

(6) Experience in, and a demonstrated record of, successful prior investments; and

(7) Appropriate proposed terms and structure for the investment.

The favorable due diligence determination, including the underlying rationale, market conditions and portfolio impact, shall be furnished in a single investment report package to OKTRS as soon as practicable in connection with any investment that is likely to be made through the Investment Committee, and in any case, at least two weeks prior to any commitment.

## IV. INVESTMENT VOTE

All investment decisions will be made by the Aldus Investment Committee. The Investment Committee meets every two weeks and is comprised of five individuals. Investment approval authority shall only be exercised with a four-fifths approval by the Investment Committee, acting upon a favorable due diligence determination by its members.

## V. LEGAL REVIEW PROCESS

Aldus will be furnished partnership documents for those investments selected by the Investment Committee. Aldus will negotiate legal terms for all partnership investments.

(1) Terms, such as preferred returns, lower fee structures, and profit splits, will be negotiated where prudent.

(2) Due to the complex nature of the Program's investments, the necessity for expert outside legal counsel shall be obtained when deemed necessary by Aldus

## VI. MONITORING AND PERFORMANCE REVIEW POLICY

Fund monitoring is an integral element of Aldus' investment process. Once a commitment has been made to a specific fund, the fund's detailed profile information is transferred from Aldus' due diligence database to the firm's proprietary monitoring database. OKTRS-specific cash flows will then be tracked and entered into the monitoring system in real-time. Fund financial statements, investment schedules, and client specific capital account balances are collected and entered into Aldus tracking system quarterly as they are released.

<u>REPORTS & UPDATES</u>

Performance reports will be prepared by Aldus will be furnished at least quarterly on Program activity and performance, and annually in an expanded format.

On a bi-annual basis, Aldus will present the state of the OKTRS portfolio to Staff and Board members. A mutually agreeable date and time is to be established at a subsequent date.

## VII. REVIEW AND MODIFICATION OF INVESTMENT POLICY STATEMENT

OKTRS may review this policy statement and procedures on an annual basis to determine if modifications are necessary or desirable.

## ACKNOWLEDGMENT

These guidelines are approved by the Teachers' Retirement System of Oklahoma and are agreed to by the advisors. It is the intention of the Teachers' Retirement System of Oklahoma to formally review these guidelines with the advisor(s) at least annually to reaffirm their continuing relevancy or revise them as appropriate. Either the Teachers' Retirement System of Oklahoma or the advisor(s) may suggest revisions at any time if it is believed to be in the best interest of the Fund.