



Division of Investment Services

STATE RETIREMENT SYSTEMS

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TEACHERS RETIREMENT SYSTEM
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Via E-mail

January 20, 2018

Mike Jung
planinfo@bc.edu

Re: Your Open Records Act Request to the Employees' Retirement System of Georgia ("ERS")

Dear Mr. Jung:

Your request, which was received by this office on July 19, 2018, has been referred to me for reply. As to your request for the 2000 - 2017 Investment Policy Statements for use to "Enrich and update Public Plans Data, a publicly available database of state and local public pension plans," please be advised that available documents responsive to your request may be found herewith.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Michael K. Majure".

Michael K. Majure

GENERAL STATEMENT OF INVESTMENT POLICY

Employees' Retirement System of Georgia

INVESTMENT OBJECTIVE AND POLICY

The Employees' Retirement System of Georgia (the Retirement System) is governed by a Board of Trustees with broad statutory powers. The investment functions of the Retirement System are vested in this Board as set forth in Georgia laws and in its Investment Committee as set forth in the By-Laws of the said Board of Trustees.

RESPONSIBILITIES OF THE TRUSTEES

By accepting the appointment as trustee, each Trustee acknowledges that he/she is a Fiduciary with responsibilities as described herein.

A fiduciary to the plan must carry out his or her duties in accordance with the plan documents and laws governing the plan. A fiduciary can delegate investment management responsibilities to qualified professional investment personnel. The fiduciary should select all investment services prudently, based solely on the beneficial services to the ultimate beneficiaries of the plan. If a fiduciary or named fiduciary delegates his or her fiduciary responsibility, the fiduciary may still be liable for a breach of fiduciary duty if such delegation is shown to have been based upon influences other than the belief that the plan was best served by the delegation.

Fiduciaries must discharge their duties with respect to the plan:

- solely in the interest of plan participants and beneficiaries;
- for the exclusive purpose of providing benefits to participants and their beneficiaries;
- with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;
- by diversifying the investments of the plan so as to minimize the risk of large losses, unless doing so is clearly not prudent under the circumstances;
- in accordance with the governing plan documents and state laws;

OBJECTIVE

The Board's investment objectives are to provide the greatest possible long-term benefits to members of the Retirement System by maximizing the total rate of return on investment within prudent limits of risk for a retirement fund of this type consistent with the investment return requirement assumed by the actuaries in determining the present and future soundness of the fund.

POLICY

First, Investment Policy is conservative in that it exhibits caution, diversifies risk, uses care in selecting securities and provides for protection against a possible substantial market decline. Secondly, Investment Policy must work toward a goal which maximizes total returns with an acceptable amount of risk to meet actuarial requirements.

Liquidity Needs

As the fund has matured, disbursements have come to exceed contributions. Investment income provides the primary source of liquidity but as the fund continues to mature liquidity needs must be consistently monitored.

Preservation of Capital

Payments from the pension fund, in many if not most instances, constitute the major source of income to retirees and the primary protection against the contingencies of death and disability of active workers. Consequently, the basic policy of the Board is preservation of the capital investment, together with realization of sufficient return to secure and facilitate payment of the statutory benefit requirements of the Retirement System to its beneficiaries.

The Board's policies provide for the utilization of all suitable and prudent avenues of investment authorized under the Georgia Statutes to maintain a high quality, diversified portfolio of investments in conservatively financed companies, the prospects of which are continually reviewed and assessed in the varying economic climate. Consistent performance of the total portfolio is emphasized. Income is expected to be a key part of investment return, not only for the portfolio as a whole but for the equity sector as well. Growth of income is a key objective, particularly in the equity sector.

Diversification

Diversification of the portfolio with respect to types of assets, types of industries, companies within industries, quality of the investment, maturities, geographic areas, etc., is an important limitation of risk. All such diversification is considered within the context of the requirements of the Georgia Statutes and the economic climate at various times to assure the maintenance of a diversified portfolio responsive to changing economic conditions. Diversification by asset types requires investments in the fixed-income area, mainly bonds and mortgages of various types, and equity investments.

Asset Allocation

The investment assets of the Employees' Retirement System are by statute, prohibited from being allocated more than seventy-five percent (75%) to equity securities on cost basis. The Division of Investment Services' policy for implementing these restrictions is to not allocate any new money to equities which would result in the total cost of equities exceeding the limit of the total cost of all investments. The cost of investments is computed using the original cost of equity securities and the amortized cost of bonds, which means that premiums and discounts are recognized totally over the life of the bonds.

Within this legal restriction, current policy is to maintain equity exposure on a cost basis between fifty-five percent (55%) and seventy-five percent (75%) and fixed income between twenty-five percent (25%) and forty-five percent (45%).

Rebalancing Asset Classes and Equity Portfolios

Since it is recognized that the fund is long term oriented, investment decisions should be made in order to maximize long term performance and should not be focused on short term movements in the financial markets.

The Investment Committee reviews the asset allocation decision and the equity portfolio mix on a yearly basis. There may, however, be times due to market or other conditions when such rebalancing may need to be considered more often. The Investment Committee has authorized the Chief Investment Officer and the Co-Chief Investment Officer to move up to 2% of the market value of the Employees' Retirement System's portfolio among asset classes between Investment Committee meetings.

In looking at the rebalancing, the Committee should focus on the asset allocation between bonds and equity and consider their longer term potential and the legal limits, as well as the needs of the Retirement System.

When looking at individual equity portfolios the Committee should:

- 1) Focus on containing the number of portfolios, as too many portfolios result in a replication of index performance at a high cost. Each portfolio is intended to add value around a risk controlled core.
- 2) Take into account the overall balance of the equity portfolios into sub classes i.e., value, growth, active, passive, and market capitalizations.
- 3) Look at each portfolio versus the equity benchmark as well as versus the applicable benchmark for the specific portfolio in terms of both return and risk. Additional evaluation criteria in the "Statement of Policy on Investment Advisory Services" should also be used.
- 4) Consider additional advisors to address a need in the portfolio while keeping total number of advisors within desired limits. If the decision to add an advisor is reached, the guidelines in the "Statement of Policy on Investment Advisory Services" should be followed.
- 5) Consider the return versus the cost of various investments in order to make the most efficient allocation.
- 6) Make the asset changes to best serve the Retirement System in the upcoming year after consideration of all relevant factors.

Short-Term Investments

It is the policy of the Retirement System to use short-term investments to provide adequate protection against downward market movements and to assist the overall return objectives. Because of the size of both the bond and equity sectors of the portfolio, and because of the essentially long-term nature of the fund, it is not anticipated that major moves will be made into or out of such cash reserves. Under normal circumstances, a reserve of 10% of the combined value of the bond and equity portfolios shall be considered the maximum limit.

Short-term investments may be made in commercial paper, master notes, U. S. Treasury obligations or repurchase agreements with the responsibility resting with the investment staff as to selection of the specific instrument to be used. Commercial paper purchases by the Retirement System shall have a maturity of not more than 180 days and shall be rated P-1 by Moody's Investment Services, Inc. and/or A-1 by Standard & Poor's Corporation. Master notes must be administered by the Custodian Bank and must be an obligation of a corporation whose commercial paper is rated P-1 by Moody's or A-1 by Standard and Poor's. Investments in commercial paper or master notes shall be limited to no more than \$500 million in any one name. Repurchase agreements shall be limited to the purchase of U. S. Treasury or Agency obligations or corporate bonds rated at least "A" by one and no lower than "A" by any major rating agency with a market value in excess of funds advanced.

Fixed-Income Investments

The fixed-income investments include both bonds and mortgages of various types carefully selected on the basis of return, quality, marketability, and overall suitability to the Retirement System's portfolio.

Bonds

It is the policy of the Retirement System that bonds shall represent an important part of the total assets of the Retirement System. The amount of this representation shall vary depending upon economic conditions, interest rates, and relative attractiveness of other available avenues of investment. The Board's policy requires that the bond portfolio be of high quality and chosen with respect to maturity ranges, coupon levels, refunding characteristics, and marketability. Active management of the bond portfolio is encouraged to continually improve the Retirement System's portfolio in terms of quality, marketability, income refunding protection, etc. Market timing, however, should not be implied by a policy of active management. The absolute size of total assets makes market timing impractical.

Investment policy must also be guided by the need to finance long-term liabilities with income return from long-term assets having a high degree of predictability. Quality bonds satisfy this need in that returns from high grade investments in fixed-income securities are highly predictable. In order to meet the quality standards it shall be the policy of the Retirement System to require that new purchases of corporate bonds be restricted to high grade bonds rated at least "A" by one and no lower than "A" by any major rating agency. If a bond in the Retirement System's portfolio is subsequently downgraded to a rating below "A" it shall be placed on a watch list and must be considered as a candidate for sale.

All bond purchases shall have a maturity greater than one year. Purchases of new issues of long-term bonds having a maturity in excess of 15 years are restricted to obligations which have at least 10 years non-refunding protection. Corporate bond investments in any one name shall also be limited to no more than 5% of total assets of the Retirement System.

Sales of bonds are specifically authorized by the Investment Committee with the exception that up to 10% of the bond position of the Retirement System may be sold between monthly Investment Committee meetings without prior approval, provided such sales in excess of 5% of the bond position of the Retirement System must be specifically approved by the Chairman of the Investment Committee prior to execution by the Investment Division. Proceeds from any such sale will be added to the outstanding bond purchase authorization. At the meeting immediately following such a sale, a full report will be made to the Committee as to the price obtained.

Canadian Provincial Obligations

Canadian obligations are legal investments and are not considered to be foreign under Georgia law. However, it has been and is currently the policy of the Retirement System to restrict purchases to new issues payable in U. S. dollars that are issued by the Provinces of Ontario, Quebec and British Columbia. Quality and call protection requirements are the same as set forth above under corporate new issue bonds. Total holdings of said Canadian obligations are limited to no more than 10% of the portfolio, 5% in any one name.

Bond Swap Program

It is the policy of the Retirement System to encourage a bond swap program so as to improve the final return to the Retirement System. Such a bond swap program shall, however, be restricted to bond swap transactions which will improve total return, call protection, quality or maturity distribution. Any other types of swaps must receive prior approval of the Investment Committee. The Division of Investment Services is authorized to make such transactions, provided justification for each swap is in writing and on file with the Division of Investment Services. The following guidelines shall control all bond swap transactions:

1. A bond swap shall be defined as a transaction involving a linked purchase and sale of a corporate, Government agency or Government obligation.
2. There shall be no swap in a security which will result in a reduction in quality below that of an "A" rating by a nationally recognized rating agency.

Private Placements of Georgia Corporations

It is the policy of the Retirement System to invest in obligations of Georgia corporations or in obligations of corporations where the proceeds from such loans are to be spent wholly in the State of Georgia. Said investments must have an investment quality equal to or better than an "A" rated bond. No such investment shall exceed 5% of total assets nor shall the total of said assets exceed 10% of total investment assets of the Retirement System. If not fully guaranteed by the United States Government each such private placement must be specifically approved by the Investment Committee.

Private Placements of U. S. Government Guaranteed Real Estate Securities

The Board is aware of the desirability of contributing to the economic well-being of the State of Georgia by encouraging home ownership. It is the policy of the Retirement System to invest in obligations secured by a first mortgage on investments which promote this goal, provided such obligations are fully guaranteed by the United States Government or are included in a "Pass-Through" security which is fully guaranteed by the United States Government. Yields on such securities should equal or exceed yields currently available on recently offered corporate bonds rated "Aaa." Private Placements of such U. S. Government guaranteed real estate securities shall be purchased and managed under the "Bonds" section of this policy.

Equity Investments

Since fixed-income investments provide only for a current income stream and make no provisions for a hedge against inflation, the policy of the Employees' Retirement System of Georgia provides that such a long-term inflation hedge be obtained by the use of equity investments. This policy provides for flexibility in a changing economic environment and allows for maximization of total return through the judicious use of a combination of both fixed-income and equity investments.

It is the policy of the Employees' Retirement System of Georgia to limit such investments in equities to no more than seventy-five percent (75%) of the book value of the total invested assets. It shall further be the policy of the Retirement System to limit an investment in the equity of any one corporation to no more than 5% of the book value of the equity portfolio and that such investment shall not exceed 5% of the outstanding equity of the issuing corporation.

In the domestic equity portion of the fund, the Employees' Retirement System of Georgia utilizes different styles of management. Passive (index based) management is utilized as a low cost, low benchmark risk strategy for a core portion of the equity assets. Active management of the common stock portfolio is based on the belief that active management can enhance returns to the fund while maintaining the same conservative investment policy which is the guiding principle behind the investment of all of the Retirement System's assets. The benchmark for the domestic equity portion of the portfolio shall be the Standard & Poor's 1500.

The Retirement System employs Investment Advisory firms to assist in active management of the common stock portfolio. Monitoring of and communications with the Advisors shall be handled in accordance with the guidelines for Performance Objective Monitoring and Communication.

It is the policy of the Employees' Retirement System of Georgia that all new investments in the actively managed portion of equities meet certain investment criteria. The purpose of the criteria is to manage capital risk and opportunity by seeking an assuredness of earnings growth and maintaining a high quality portfolio. The investment criteria can be classified as external or internal. The external criteria refer to the quality ratings provided by the major ratings agencies. The internal ratings refer to the quality ratings the Division of Investment Services assigns to individual companies.

The external and internal ratings are derived from a number of quantitative and qualitative criteria. The criteria include, but are not limited to the following areas:

- The debt level of the company
- The cash flow of the company
- The earnings stability of the company
- The secular growth rate of the company
- The self-financing ability of the company
- The accounting quality and history of the company
- The trend of profit margins and returns on equity of the company
- The degree to which the company has control over its destiny
- The dominant or unique position of the company within its industry
- The complexity and understandability of the corporate profile
- The quality of the company's management including integrity, innovative capacity, motivation, accessibility, and depth

Requiring a company to exceed a specific rating, based upon the comprehensive analysis of a multitude of criteria has proven to be a highly useful aid in selecting companies capable of enduring the ups and downs of business cycles.

After an analysis based on the above criteria, a company may be considered qualified for inclusion on Employees' "Master Approved List of Common Stocks". The Employees' Master Approved List will be a current list of companies maintained by the Division of Investment Services, which are considered to meet a level of risk and potential return suitable for the Employees' Retirement System of Georgia.

If an Investment Advisory firm requests approval to invest in a company on the Master Approved List, permission by the Investment Committee for buying the respective common stock could be arrived at both expeditiously and with a rather high level of conviction that the company, barring unforeseen economic conditions, will likely prove to be a prudent investment for the Employees' Retirement System of Georgia. If an Investment Advisory firm requests approval to invest in a company not on the Master Approved List, the company will be subject to additional scrutiny or examination by the Division of Investment Services.

Small capitalization portfolios with large numbers of rather new, fast growing companies, always face some perceived deficiencies regarding operating history, stability, or quality of management in comparison to larger capitalization portfolios. Moreover, the inclusion of a sufficient number of *qualified* small companies in a small capitalization portfolio that tracks closely a benchmark like the S&P 600 can be a complex task. Nevertheless, the favorable risk/return characteristics of small capitalization portfolios have proven over history to be a sound diversifying asset class for the total portfolio of retirement systems. In the case of small capitalization portfolios, the Division of Investment Services and the Investment Committee will take into consideration the rather unique attributes of these companies before determining their eligibility for addition to any advisor's small capitalization approved list or any future small capitalization master approved list.

Also included in the equity portion of the portfolio are international equities, as defined by Georgia Law (47-20-83). These companies provide increased exposure to some of the more rapidly growing areas of the world as well as those with differing economic cycles.

Corresponding to the domestic equity portion of the fund, passive (index based) management of international equities is utilized as a low cost, low benchmark risk strategy for a core position of international equity assets. Active management of international equities may be utilized based on the belief – similar to domestic equities – that active management can enhance returns while maintaining a conservative investment policy.

It is generally the policy of the Employees' Retirement System of Georgia that all new investments in the actively managed portion of international equities meet similar investment criteria as domestic equities (see above). For international companies, however, historical financial data is not as easy to obtain and may be sparse for some companies, especially those in the emerging markets. Therefore, for some international companies it may be necessary to accept reduced financial history and information as compared to that which is available for domestic equities. Identical to domestic equities, an international company that passes an analysis of the investment criteria is considered qualified for inclusion in the Employees' "Master Approved List of Common Stocks".

In the same manner as domestic equities, if an Investment Advisory firm requests approval to invest in an international company on the Master Approved List, permission by the Investment Committee for buying the respective common stock could be arrived at both expeditiously and with a rather high level of conviction that the company, barring unforeseen economic conditions, will likely prove to be a prudent investment for the Employees' Retirement System of Georgia. If an Investment Advisory firm requests approval to invest in an international company not on the Master Approved List, the company will be subject to additional examination by the Division of Investment Services.

Similar to the caveat relating to small capitalization companies, some securities of foreign companies, especially companies in emerging markets, could be deficient, to a degree, in meeting the aforementioned investment criteria. Nevertheless, the favorable risk/return characteristics of foreign company portfolios have proven over history to be a sound diversifying asset class for the total portfolio of retirement systems. As in the case of small capitalization portfolios, the Division of Investment Services and the Investment Committee will take into consideration the specific attributes of each foreign company before assessing its addition to any advisor's approved list.

Common stocks eligible for investment shall be approved by the Investment Committee. A list of approved stock investments shall be maintained by the Investment Division for each advisor's fund and the in-house funds. Said lists shall at all times meet the investment criteria heretofore referred to and at no time shall any one advisor's list exceed the number of names established by the investment staff as appropriate for each investment advisor. No addition to an approved list shall be made without the approval of the Committee except by the inter-meeting procedure of adding a name from the Master Approved List as detailed below.

1. Prior to allowing the addition of a name to an approved list, approval of the Chairman or the Vice Chairman of the Investment Committee or the Chief Investment Officer or Co-Chief Investment Officer of the Division of Investment Services shall be obtained.
2. Stocks added to an index will be reviewed for appropriateness of ownership from a portfolio management perspective in the in-house funds.
3. To ensure the ability of the advisors to buy and sell a company's stock as desired, the trading liquidity of the shares will be reviewed to determine if addition is appropriate.
4. Stocks owned in a fund must be approved and are available for addition to other funds. Additionally, stocks resulting from corporate actions such as but not limited to reorganizations, spin-offs, or mergers shall be deemed to be approved.
5. With the exception of corporate actions, additions under this policy will be confirmed in person at a meeting of the Investment Committee.

When securities of individual companies are prohibited from being purchased as a consequence of State law or by Investment Committee policy, the Division of Investment Services shall maintain a list of those prohibited investments and provide it to all advisors.

Sales of equities are specifically authorized by the Investment Committee with the exception that up to 15% of the equity position of the Retirement System may be sold per calendar month without prior approval. However, sales in excess of 5% of the equity position of the Retirement System must be specifically approved by the Chief Investment Officer or Co-Chief Investment Officer of the Division of Investment Services and sales in excess of 10% of the equity position of the Retirement System must be specifically approved by the Chairman or Vice Chairman of the Investment Committee prior to execution by the Investment Division. At the meeting immediately following such a sale, a full report will be made to

the Committee as to 1) the price obtained; and 2) whether the funds were reinvested in common stocks or were being held in a short-term investment.

Real Estate

Real Estate assets of the Employees' Retirement System of Georgia are limited and restricted by law solely to any structure occupied by the Retirement System and to real property acquired through judicial foreclosure of mortgage loans owned and held by the Retirement System at time of foreclosure, or by any other judicial or court action that assigns ownership of real property to the Retirement System. It is the policy of the Retirement System to make every effort to sell or otherwise dispose of all such property except that of any structure occupied by the Retirement System within five years of date of acquisition.

Anti-Terrorism

The Board of Trustees, in recognition of laws and sanctions based on national security goals and the fight against terrorism, has adopted an Anti-Terrorism Policy. The Policy prohibits investments in partnerships, corporations, and organizations who provide support, services, assistance, or otherwise associate with terrorists or their agents; who are engaged in international narcotics trafficking or in activities related to the proliferation of weapons of mass destruction; and, who may pose other threats to the national security of the United States.

Accordingly, the Division of Investment Services will not purchase or own any investments that are designated as Foreign Terrorist Organizations by the U.S. Department of State or are listed on the U.S. Department of the Treasury Specially Designated Nationals List.

Proxy Votes

It is the fiduciary responsibility of the Trustees of the Employees' Retirement System of Georgia to vote all proxies solely and exclusively in the best economic interests of the Retirement System. Accordingly, it is the policy of the Employees' Retirement System of Georgia to vote and execute all voting proxies in support of management except where, in the opinion of the Chief Investment Officer or Co-Chief Investment Officer of the Division of Investment Services such a vote would be detrimental to the best interests or rights of the Retirement System. A standing exception to this policy of voting with management is to always vote in favor of confidential proxy balloting as this has been determined to be in the best interests of the Retirement System.

Securities Fraud

The Board, in its fiduciary role, is cognizant of the possibility of securities fraud or illegal activity that may adversely impact the financial interests of the Retirement System. In the event evidence of such activity is detected, the Board should consider appropriate remedies. Accordingly, the Investment Division shall have standing instructions to take reasonable steps to identify and inform itself regarding allegations of securities fraud related to a company in which the Retirement System has a position. If the Investment Division finds that there are reasonable grounds to believe that the Retirement System has suffered a loss as a result of securities fraud, it shall evaluate the extent of the losses sustained by the Retirement System as a result thereof and promptly report its conclusions and recommendations to the Investment Committee of the Board. This will allow the Board to evaluate the potential claim and to determine an appropriate course of action, including the possibility of initiating or participating in litigation.

Personal Integrity

Participation in the affairs of any public body demands a high level of personal integrity and conduct. Especially is this true when wise utilization of the funds of others is involved. Members of the Board of Trustees and their investment staff must discharge their responsibilities without prejudice or favor, avoiding at all times pressures from social issues and any conduct which could create a conflict of interest.

GENERAL STATEMENT OF INVESTMENT POLICY

Employees' Retirement System of Georgia

INVESTMENT OBJECTIVE AND POLICY

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- with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;
- by diversifying the investments of the plan so as to minimize the risk of large losses, unless doing so is clearly not prudent under the circumstances;
- in accordance with the governing plan documents and state laws;
- by being as prudent as the average expert, not simply the average person.

OBJECTIVE

The Board's investment objectives are to provide the greatest possible long-term benefits to members of the Retirement System by maximizing the total rate of return on investment within prudent limits of risk for a retirement fund of this type consistent with the investment return requirement assumed by the actuaries in determining the present and future soundness of the fund.

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It is the policy of the Retirement System that bonds shall represent an important part of the total assets of the Retirement System. The amount of this representation shall vary depending upon economic conditions, interest rates, and relative attractiveness of other available avenues of investment. The Board's policy requires that the bond portfolio be of high quality and chosen with respect to maturity ranges, coupon levels, refunding characteristics, and marketability. Active management of the bond portfolio is encouraged to continually improve the Retirement System's portfolio in terms of quality, marketability, income refunding protection, etc. Market timing, however, should not be implied by a policy of active management. The absolute size of total assets makes market timing impractical.

Investment policy must also be guided by the need to finance long-term liabilities with income return from long-term assets having a high degree of predictability. Quality bonds satisfy this need in that returns from high grade investments in fixed-income securities are highly predictable. In order to meet the quality standards it shall be the policy of the Retirement System to require that new purchases of corporate bonds be restricted to high grade bonds rated at least "A" by one and no lower than "A" by any major rating agency. If a bond in the Retirement System's portfolio is subsequently downgraded to a rating below "A" it shall be placed on a watch list and must be considered as a candidate for sale.

All bond purchases shall have a maturity greater than one year. Purchases of new issues of long-term bonds having a maturity in excess of 15 years are restricted to obligations which have at least 10 years non-refunding protection. Corporate bond investments in any one name shall also be limited to no more than 5% of total assets of the Retirement System.

Sales of bonds are specifically authorized by the Investment Committee with the exception that up to 10% of the bond position of the Retirement System may be sold between monthly Investment Committee meetings without prior approval, provided such sales in excess of 5% of the bond position of the Retirement System must be specifically approved by the Chairman of the Investment Committee prior to execution by the Investment Division. Proceeds from any such sale will be added to the outstanding bond purchase authorization. At the meeting immediately following such a sale, a full report will be made to the Committee as to the price obtained.

Canadian Provincial Obligations

Canadian obligations are legal investments and are not considered to be foreign under Georgia law. However, it has been and is currently the policy of the Retirement System to restrict purchases to new issues payable in U. S. dollars that are issued by the Provinces of Ontario, Quebec and British Columbia. Quality and call protection requirements are the same as set forth above under corporate new issue bonds. Total holdings of said Canadian obligations are limited to no more than 10% of the portfolio, 5% in any one name.

Bond Swap Program

It is the policy of the Retirement System to encourage a bond swap program so as to improve the final return to the Retirement System. Such a bond swap program shall, however, be restricted to bond swap transactions which will improve total return, call protection, quality or maturity distribution. Any other types of swaps must receive prior approval of the Investment Committee. The Division of Investment Services is authorized to make such transactions, provided justification for each swap is in writing and on file with the Division of Investment Services. The following guidelines shall control all bond swap transactions:

1. A bond swap shall be defined as a transaction involving a linked purchase and sale of a corporate, Government agency or Government obligation.
2. There shall be no swap in a security which will result in a reduction in quality below that of an "A" rating by a nationally recognized rating agency.

Private Placements of Georgia Corporations

It is the policy of the Retirement System to invest in obligations of Georgia corporations or in obligations of corporations where the proceeds from such loans are to be spent wholly in the State of Georgia. Said investments must have an investment quality equal to or better than an "A" rated bond. No such investment shall exceed 5% of total assets nor shall the total of said assets exceed 10% of total investment assets of the Retirement System. If not fully guaranteed by the United States Government each such private placement must be specifically approved by the Investment Committee.

Private Placements of U. S. Government Guaranteed Real Estate Securities

The Board is aware of the desirability of contributing to the economic well-being of the State of Georgia by encouraging home ownership. It is the policy of the Retirement System to invest in obligations secured by a first mortgage on investments which promote this goal, provided such obligations are fully guaranteed by the United States Government or are included in a "Pass-Through" security which is fully guaranteed by the United States Government. Yields on such securities should equal or exceed yields currently available on recently offered corporate bonds rated "Aaa." Private Placements of such U. S. Government guaranteed real estate securities shall be purchased and managed under the "Bonds" section of this policy.

Equity Investments

Since fixed-income investments provide only for a current income stream and make no provisions for a hedge against inflation, the policy of the Employees' Retirement System of Georgia provides that such a long-term inflation hedge be obtained by the use of equity investments. This policy provides for flexibility in a changing economic environment and allows for maximization of total return through the judicious use of a combination of both fixed-income and equity investments.

It is the policy of the Employees' Retirement System of Georgia to limit such investments in equities to no more than seventy-five percent (75%) of the book value of the total invested assets. It shall further be the policy of the Retirement System to limit an investment in the equity of any one corporation to no more than 5% of the book value of the equity portfolio and that such investment shall not exceed 5% of the outstanding equity of the issuing corporation.

In the domestic equity portion of the fund, the Employees' Retirement System of Georgia utilizes different styles of management. Passive (index based) management is utilized as a low cost, low benchmark risk strategy for a core portion of the equity assets. Active management of the common stock portfolio is based on the belief that active management can enhance returns to the fund while maintaining the same conservative investment policy which is the guiding principle behind the investment of all of the Retirement System's assets. The benchmark for the domestic equity portion of the portfolio shall be the Standard & Poor's 1500.

The Retirement System employs Investment Advisory firms to assist in active management of the common stock portfolio. Monitoring of and communications with the Advisors shall be handled in accordance with the guidelines for Performance Objective Monitoring and Communication.

It is the policy of the Employees' Retirement System of Georgia that all new investments in the actively managed portion of equities meet certain investment criteria. The purpose of the criteria is to manage capital risk and opportunity by seeking an assuredness of earnings growth and maintaining a high quality portfolio. The investment criteria can be classified as external or internal. The external criteria refer to the quality ratings provided by the major ratings agencies. The internal ratings refer to the quality ratings the Division of Investment Services assigns to individual companies.

The external and internal ratings are derived from a number of quantitative and qualitative criteria. The criteria include, but are not limited to the following areas:

- The debt level of the company
- The cash flow of the company
- The earnings stability of the company
- The secular growth rate of the company
- The self-financing ability of the company
- The accounting quality and history of the company
- The trend of profit margins and returns on equity of the company
- The degree to which the company has control over its destiny
- The dominant or unique position of the company within its industry
- The complexity and understandability of the corporate profile
- The quality of the company's management including integrity, innovative capacity, motivation, accessibility, and depth

Requiring a company to exceed a specific rating, based upon the comprehensive analysis of a multitude of criteria has proven to be a highly useful aid in selecting companies capable of enduring the ups and downs of business cycles.

After an analysis based on the above criteria, a company may be considered qualified for inclusion on Employees' "Master Approved List of Common Stocks". The Employees' Master Approved List will be a current list of companies maintained by the Division of Investment Services, which are considered to meet a level of risk and potential return suitable for the Employees' Retirement System of Georgia.

If an Investment Advisory firm requests approval to invest in a company on the Master Approved List, permission by the Investment Committee for buying the respective common stock could be arrived at both expeditiously and with a rather high level of conviction that the company, barring unforeseen economic conditions, will likely prove to be a prudent investment for the Employees' Retirement System of Georgia. If an Investment Advisory firm requests approval to invest in a company not on the Master Approved List, the company will be subject to additional scrutiny or examination by the Division of Investment Services.

Small capitalization portfolios with large numbers of rather new, fast growing companies, always face some perceived deficiencies regarding operating history, stability, or quality of management in comparison to larger capitalization portfolios. Moreover, the inclusion of a sufficient number of *qualified* small companies in a small capitalization portfolio that tracks closely a benchmark like the S&P 600 can be a complex task. Nevertheless, the favorable risk/return characteristics of small capitalization portfolios have proven over history to be a sound diversifying asset class for the total portfolio of retirement systems. In the case of small capitalization portfolios, the Division of Investment Services and the Investment Committee will take into consideration the rather unique attributes of these companies before determining their eligibility for addition to any advisor's small capitalization approved list or any future small capitalization master approved list.

Also included in the equity portion of the portfolio are international equities, as defined by Georgia Law (47-20-83). These companies provide increased exposure to some of the more rapidly growing areas of the world as well as those with differing economic cycles.

Corresponding to the domestic equity portion of the fund, passive (index based) management of international equities is utilized as a low cost, low benchmark risk strategy for a core position of international equity assets. Active management of international equities may be utilized based on the belief – similar to domestic equities – that active management can enhance returns while maintaining a conservative investment policy. The benchmarks for the international equity portion of the portfolio shall be the MSCI EAFE and the MSCI ACWI ex. U.S. ex. Iran Free Indices.

It is generally the policy of the Employees' Retirement System of Georgia that all new investments in the actively managed portion of international equities meet similar investment criteria as domestic equities (see above). For international companies, however, historical financial data is not as easy to obtain and may be sparse for some companies, especially those in the emerging markets. Therefore, for some international companies it may be necessary to accept reduced financial history and information as compared to that which is available for domestic equities. Identical to domestic equities, an international company that passes an analysis of the investment criteria is considered qualified for inclusion in the Employees' "Master Approved List of Common Stocks".

In the same manner as domestic equities, if an Investment Advisory firm requests approval to invest in an international company on the Master Approved List, permission by the Investment Committee for buying the respective common stock could be arrived at both expeditiously and with a rather high level of conviction that the company, barring unforeseen economic conditions, will likely prove to be a prudent investment for the Employees' Retirement System of Georgia. If an Investment Advisory firm requests approval to invest in an international company not on the Master Approved List, the company will be subject to additional examination by the Division of Investment Services.

Similar to the caveat relating to small capitalization companies, some securities of foreign companies, especially companies in emerging markets, could be deficient, to a degree, in meeting the aforementioned investment criteria. Nevertheless, the favorable risk/return characteristics of foreign company portfolios have proven over history to be a sound diversifying asset class for the total portfolio of retirement systems. As in the case of small capitalization portfolios, the Division of Investment Services and the Investment Committee will take into consideration the specific attributes of each foreign company before assessing its addition to any advisor's approved list.

Common stocks eligible for investment shall be approved by the Investment Committee. A list of approved stock investments shall be maintained by the Investment Division for each advisor's fund and the in-house funds. No addition to an approved list shall be made without the approval of the Committee except by the inter-meeting procedure of adding a name from the Master Approved List as detailed below.

1. Prior to allowing the addition of a name to an approved list, approval of the Chairman or the Vice Chairman of the Investment Committee or the Chief Investment Officer or Co-Chief Investment Officer of the Division of Investment Services shall be obtained.
2. Stocks added to an index will be reviewed for appropriateness of ownership from a portfolio management perspective in the in-house funds.
3. To ensure the ability of the advisors to buy and sell a company's stock as desired, the trading liquidity of the shares will be reviewed to determine if addition is appropriate.
4. Stocks owned in a fund must be approved.
5. Additions under this policy will be confirmed in person at a meeting of the Investment Committee.

When securities of individual companies are prohibited from being purchased as a consequence of State law or by Investment Committee policy, the Division of Investment Services shall maintain a list of those prohibited investments and provide it to all advisors.

Sales of equities are specifically authorized by the Investment Committee with the exception that up to 15% of the equity position of the Retirement System may be sold between monthly Investment Committee meetings without prior approval. However, sales in excess of 5% of the equity position of the Retirement System must be specifically approved by the Chief Investment Officer or Co-Chief Investment Officer of the Division of Investment Services and sales in excess of 10% of the equity position of the Retirement System must be specifically approved by the Chairman or Vice Chairman of the Investment Committee prior to execution by the Investment Division. At the meeting immediately following such a sale, a full report will be made to the Committee as to 1) the price obtained; and 2) whether the funds were reinvested in common stocks or were being held in a short-term investment.

Real Estate assets of the Employees' Retirement System of Georgia are limited and restricted by law solely to any structure occupied by the Retirement System and to real property acquired through judicial foreclosure of mortgage loans owned and held by the Retirement System at time of foreclosure, or by any other judicial or court action that assigns ownership of real property to the Retirement System. It is the policy of the Retirement System to make every effort to sell or otherwise dispose of all such property except that of any structure occupied by the Retirement System within five years of date of acquisition.

Anti-Terrorism

The Board of Trustees, in recognition of laws and sanctions based on national security goals and the fight against terrorism, has adopted an Anti-Terrorism Policy. The Policy prohibits investments in partnerships, corporations, and organizations who provide support, services, assistance, or otherwise associate with terrorists or their agents; who are engaged in international narcotics trafficking or in activities related to the proliferation of weapons of mass destruction; and, who may pose other threats to the national security of the United States.

Accordingly, the Division of Investment Services will not purchase or own any investments that are designated as Foreign Terrorist Organizations by the U.S. Department of State or are listed on the U.S. Department of the Treasury Specially Designated Nationals List.

Proxy Votes

It is the fiduciary responsibility of the Trustees of the Employees' Retirement System of Georgia to vote all proxies solely and exclusively in the best economic interests of the Retirement System. Accordingly, it is the policy of the Employees' Retirement System of Georgia to vote and execute all voting proxies in support of management except where, in the opinion of the Chief Investment Officer or Co-Chief Investment Officer of the Division of Investment Services such a vote would be detrimental to the best interests or rights of the Retirement System. A standing exception to this policy of voting with management is to always vote in favor of confidential proxy balloting as this has been determined to be in the best interests of the Retirement System.

Securities Fraud

The Board, in its fiduciary role, is cognizant of the possibility of securities fraud or illegal activity that may adversely impact the financial interests of the Retirement System. In the event evidence of such activity is detected, the Board should consider appropriate remedies. Accordingly, the Investment Division shall have standing instructions to take reasonable steps to identify and inform itself regarding allegations of securities fraud related to a company in which the Retirement System has a position. If the Investment Division finds that there are reasonable grounds to believe that the Retirement System has suffered a loss as a result of securities fraud, it shall evaluate the extent of the losses sustained by the Retirement System as a result thereof and promptly report its conclusions and recommendations to the Investment Committee of the Board. This will allow the Board to evaluate the potential claim and to determine an appropriate course of action, including the possibility of initiating or participating in litigation.

Personal Integrity

Participation in the affairs of any public body demands a high level of personal integrity and conduct. Especially is this true when wise utilization of the funds of others is involved. Members of the Board of Trustees and their investment staff must discharge their responsibilities without prejudice or favor, avoiding at all times pressures from social issues and any conduct which could create a conflict of interest.

GENERAL STATEMENT OF INVESTMENT POLICY

Employees' Retirement System of Georgia

INVESTMENT OBJECTIVE AND POLICY

The Employees' Retirement System of Georgia (the Retirement System) is governed by a Board of Trustees with broad statutory powers. The investment functions of the Retirement System are vested in this Board as set forth in Georgia laws and in its Investment Committee as set forth in the By-Laws of the said Board of Trustees.

RESPONSIBILITIES OF THE TRUSTEES

By accepting the appointment as trustee, each Trustee acknowledges that he/she is a Fiduciary with responsibilities as described herein.

A fiduciary to the plan must carry out his or her duties in accordance with the plan documents and laws governing the plan. A fiduciary can delegate investment management responsibilities to qualified professional investment personnel. The fiduciary should select all investment services prudently, based solely on the beneficial services to the ultimate beneficiaries of the plan. If a fiduciary or named fiduciary delegates his or her fiduciary responsibility, the fiduciary may still be liable for a breach of fiduciary duty if such delegation is shown to have been based upon influences other than the belief that the plan was best served by the delegation.

Fiduciaries must discharge their duties with respect to the plan:

- solely in the interest of plan participants and beneficiaries;
- for the exclusive purpose of providing benefits to participants and their beneficiaries;
- with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;
- by diversifying the investments of the plan so as to minimize the risk of large losses, unless doing so is clearly not prudent under the circumstances;
- in accordance with the governing plan documents and state laws;
- by being as prudent as the average expert, not simply the average person.

OBJECTIVE

The Board's investment objectives are to provide the greatest possible long-term benefits to members of the Retirement System by maximizing the total rate of return on investment within prudent limits of risk for a retirement fund of this type consistent with the investment return requirement assumed by the actuaries in determining the present and future soundness of the fund.

POLICY

First, Investment Policy is conservative in that it exhibits caution, diversifies risk, uses care in selecting securities and provides for protection against a possible substantial market decline. Secondly, Investment Policy must work toward a goal which maximizes total returns with an acceptable amount of risk to meet actuarial requirements.

Liquidity Needs

As the fund has matured, disbursements have come to exceed contributions. Investment income provides the primary source of liquidity but as the fund continues to mature liquidity needs must be consistently monitored.

Preservation of Capital

Payments from the pension fund, in many if not most instances, constitute the major source of income to retirees and the primary protection against the contingencies of death and disability of active workers. Consequently, the basic policy of the Board is preservation of the capital investment, together with realization of sufficient return to secure and facilitate payment of the statutory benefit requirements of the Retirement System to its beneficiaries.

The Board's policies provide for the utilization of all suitable and prudent avenues of investment authorized under the Georgia Statutes to maintain a high quality, diversified portfolio of investments in conservatively financed companies, the prospects of which are continually reviewed and assessed in the varying economic climate. Consistent performance of the total portfolio is emphasized. Income is expected to be a key part of investment return, not only for the portfolio as a whole but for the equity sector as well. Growth of income is a key objective, particularly in the equity sector.

Diversification

Diversification of the portfolio with respect to types of assets, types of industries, companies within industries, quality of the investment, maturities, geographic areas, etc., is an important limitation of risk. All such diversification is considered within the context of the requirements of the Georgia Statutes and the economic climate at various times to assure the maintenance of a diversified portfolio responsive to changing economic conditions. Diversification by asset types requires investments in the fixed-income area, mainly bonds and mortgages of various types, and equity investments.

Asset Allocation

The investment assets of the Employees' Retirement System are by statute, prohibited from being allocated more than seventy-five percent (75%) to equity securities on cost basis. The Division of Investment Services' policy for implementing these restrictions is to not allocate any new money to equities which would result in the total cost of equities exceeding the limit of the total cost of all investments. The cost of investments is computed using the original cost of equity securities and the amortized cost of bonds, which means that premiums and discounts are recognized totally over the life of the bonds.

Within this legal restriction, current policy is to maintain equity exposure on a cost basis between fifty-five percent (55%) and seventy-five percent (75%) and fixed income between twenty-five percent (25%) and forty-five percent (45%).

Rebalancing Asset Classes and Equity Portfolios

Since it is recognized that the fund is long term oriented, investment decisions should be made in order to maximize long term performance and should not be focused on short term movements in the financial markets.

The Investment Committee reviews the asset allocation decision and the equity portfolio mix on a yearly basis. There may, however, be times due to market or other conditions when such rebalancing may need to be considered more often. The Investment Committee has authorized the Chief Investment Officer and the Co-Chief Investment Officer to move up to 2% of the market value of the Employees' Retirement System's portfolio among asset classes between Investment Committee meetings.

In looking at the rebalancing, the Committee should focus on the asset allocation between bonds and equity and consider their longer term potential and the legal limits, as well as the needs of the Retirement System.

When looking at individual equity portfolios the Committee should:

- 1) Focus on containing the number of portfolios, as too many portfolios result in a replication of index performance at a high cost. Each portfolio is intended to add value around a risk controlled core.
- 2) Take into account the overall balance of the equity portfolios into sub classes i.e., value, growth, active, passive, and market capitalizations.
- 3) Look at each portfolio versus the equity benchmark as well as versus the applicable benchmark for the specific portfolio in terms of both return and risk. Additional evaluation criteria in the "Statement of Policy on Investment Advisory Services" should also be used.
- 4) Consider additional advisors to address a need in the portfolio while keeping total number of advisors within desired limits. If the decision to add an advisor is reached, the guidelines in the "Statement of Policy on Investment Advisory Services" should be followed.
- 5) Consider the return versus the cost of various investments in order to make the most efficient allocation.
- 6) Make the asset changes to best serve the Retirement System in the upcoming year after consideration of all relevant factors.

Short-Term Investments

It is the policy of the Retirement System to use short-term investments to provide adequate protection against downward market movements and to assist the overall return objectives. Because of the size of both the bond and equity sectors of the portfolio, and because of the essentially long-term nature of the fund, it is not anticipated that major moves will be made into or out of such cash reserves. Under normal circumstances, a reserve of 10% of the combined value of the bond and equity portfolios shall be considered the maximum limit.

Short-term investments may be made in commercial paper, master notes, U. S. Treasury obligations or repurchase agreements with the responsibility resting with the investment staff as to selection of the specific instrument to be used. Commercial paper purchases by the Retirement System shall have a maturity of not more than 180 days and shall be rated P-1 by Moody's Investment Services, Inc. and/or A-1 by Standard & Poor's Corporation. Master notes must be administered by the Custodian Bank and must be an obligation of a corporation whose commercial paper is rated P-1 by Moody's or A-1 by Standard and Poor's. Investments in commercial paper or master notes shall be limited to no more than \$500 million in any one name. Repurchase agreements shall be limited to the purchase of U. S. Treasury or Agency obligations or corporate bonds rated at least "A" by one and no lower than "A" by any major rating agency with a market value in excess of funds advanced.

Fixed-Income Investments

The fixed-income investments include both bonds and mortgages of various types carefully selected on the basis of return, quality, marketability, and overall suitability to the Retirement System's portfolio.

Bonds

It is the policy of the Retirement System that bonds shall represent an important part of the total assets of the Retirement System. The amount of this representation shall vary depending upon economic conditions, interest rates, and relative attractiveness of other available avenues of investment. The Board's policy requires that the bond portfolio be of high quality and chosen with respect to maturity ranges, coupon levels, refunding characteristics, and marketability. Active management of the bond portfolio is encouraged to continually improve the Retirement System's portfolio in terms of quality, marketability, income refunding protection, etc. Market timing, however, should not be implied by a policy of active management. The absolute size of total assets makes market timing impractical.

Investment policy must also be guided by the need to finance long-term liabilities with income return from long-term assets having a high degree of predictability. Quality bonds satisfy this need in that returns from high grade investments in fixed-income securities are highly predictable. In order to meet the quality standards it shall be the policy of the Retirement System to require that new purchases of corporate bonds be restricted to high grade bonds rated at least "A" by one and no lower than "A" by any major rating agency. If a bond in the Retirement System's portfolio is subsequently downgraded to a rating below "A" it shall be placed on a watch list and must be considered as a candidate for sale.

All bond purchases shall have a maturity greater than one year. Purchases of new issues of long-term bonds having a maturity in excess of 15 years are restricted to obligations which have at least 10 years non-refunding protection. Corporate bond investments in any one name shall also be limited to no more than 5% of total assets of the Retirement System.

Sales of bonds are specifically authorized by the Investment Committee with the exception that up to 10% of the bond position of the Retirement System may be sold between monthly Investment Committee meetings without prior approval, provided such sales in excess of 5% of the bond position of the Retirement System must be specifically approved by the Chairman of the Investment Committee prior to execution by the Investment Division. Proceeds from any such sale will be added to the outstanding bond purchase authorization. At the meeting immediately following such a sale, a full report will be made to the Committee as to the price obtained.

Canadian Provincial Obligations

Canadian obligations are legal investments and are not considered to be foreign under Georgia law. However, it has been and is currently the policy of the Retirement System to restrict purchases to new issues payable in U. S. dollars that are issued by the Provinces of Ontario, Quebec and British Columbia. Quality and call protection requirements are the same as set forth above under corporate new issue bonds. Total holdings of said Canadian obligations are limited to no more than 10% of the portfolio, 5% in any one name.

Bond Swap Program

It is the policy of the Retirement System to encourage a bond swap program so as to improve the final return to the Retirement System. Such a bond swap program shall, however, be restricted to bond swap transactions which will improve total return, call protection, quality or maturity distribution. Any other types of swaps must receive prior approval of the Investment Committee. The Division of Investment Services is authorized to make such transactions, provided justification for each swap is in writing and on file with the Division of Investment Services. The following guidelines shall control all bond swap transactions:

1. A bond swap shall be defined as a transaction involving a linked purchase and sale of a corporate, Government agency or Government obligation.
2. There shall be no swap in a security which will result in a reduction in quality below that of an "A" rating by a nationally recognized rating agency.

Private Placements of Georgia Corporations

It is the policy of the Retirement System to invest in obligations of Georgia corporations or in obligations of corporations where the proceeds from such loans are to be spent wholly in the State of Georgia. Said investments must have an investment quality equal to or better than an "A" rated bond. No such investment shall exceed 5% of total assets nor shall the total of said assets exceed 10% of total investment assets of the Retirement System. If not fully guaranteed by the United States Government each such private placement must be specifically approved by the Investment Committee.

Private Placements of U. S. Government Guaranteed Real Estate Securities

The Board is aware of the desirability of contributing to the economic well-being of the State of Georgia by encouraging home ownership. It is the policy of the Retirement System to invest in obligations secured by a first mortgage on investments which promote this goal, provided such obligations are fully guaranteed by the United States Government or are included in a "Pass-Through" security which is fully guaranteed by the United States Government. Yields on such securities should equal or exceed yields currently available on recently offered corporate bonds rated "Aaa." Private Placements of such U. S. Government guaranteed real estate securities shall be purchased and managed under the "Bonds" section of this policy.

Equity Investments

Since fixed-income investments provide only for a current income stream and make no provisions for a hedge against inflation, the policy of the Employees' Retirement System of Georgia provides that such a long-term inflation hedge be obtained by the use of equity investments. This policy provides for flexibility in a changing economic environment and allows for maximization of total return through the judicious use of a combination of both fixed-income and equity investments.

It is the policy of the Employees' Retirement System of Georgia to limit such investments in equities to no more than seventy-five percent (75%) of the book value of the total invested assets. It shall further be the policy of the Retirement System to limit an investment in the equity of any one corporation to no more than 5% of the book value of the equity portfolio and that such investment shall not exceed 5% of the outstanding equity of the issuing corporation.

In the domestic equity portion of the fund, the Employees' Retirement System of Georgia utilizes different styles of management. Passive (index based) management is utilized as a low cost, low benchmark risk strategy for a core portion of the equity assets. Active management of the common stock portfolio is based on the belief that active management can enhance returns to the fund while maintaining the same conservative investment policy which is the guiding principle behind the investment of all of the Retirement System's assets. The benchmark for the domestic equity portion of the portfolio shall be the Standard & Poor's 1500.

The Retirement System employs Investment Advisory firms to assist in active management of the common stock portfolio. Monitoring of and communications with the Advisors shall be handled in accordance with the guidelines for Performance Objective Monitoring and Communication.

It is the policy of the Employees' Retirement System of Georgia that all new investments in the actively managed portion of equities meet certain investment criteria. The purpose of the criteria is to manage capital risk and opportunity by seeking an assuredness of earnings growth and maintaining a high quality portfolio. The investment criteria can be classified as external or internal. The external criteria refer to the quality ratings provided by the major ratings agencies. The internal ratings refer to the quality ratings the Division of Investment Services assigns to individual companies.

The external and internal ratings are derived from a number of quantitative and qualitative criteria. The criteria include, but are not limited to the following areas:

- The debt level of the company
- The cash flow of the company
- The earnings stability of the company
- The secular growth rate of the company
- The self-financing ability of the company
- The accounting quality and history of the company
- The trend of profit margins and returns on equity of the company
- The degree to which the company has control over its destiny
- The dominant or unique position of the company within its industry
- The complexity and understandability of the corporate profile
- The quality of the company's management including integrity, innovative capacity, motivation, accessibility, and depth

Requiring a company to exceed a specific rating, based upon the comprehensive analysis of a multitude of criteria has proven to be a highly useful aid in selecting companies capable of enduring the ups and downs of business cycles.

After an analysis based on the above criteria, a company may be considered qualified for inclusion on Employees' "Master Approved List of Common Stocks". The Employees' Master Approved List will be a current list of companies maintained by the Division of Investment Services, which are considered to meet a level of risk and potential return suitable for the Employees' Retirement System of Georgia.

If an Investment Advisory firm requests approval to invest in a company on the Master Approved List, permission by the Investment Committee for buying the respective common stock could be arrived at both expeditiously and with a rather high level of conviction that the company, barring unforeseen economic conditions, will likely prove to be a prudent investment for the Employees' Retirement System of Georgia. If an Investment Advisory firm requests approval to invest in a company not on the Master Approved List, the company will be subject to additional scrutiny or examination by the Division of Investment Services.

Small capitalization portfolios with large numbers of rather new, fast growing companies, always face some perceived deficiencies regarding operating history, stability, or quality of management in comparison to larger capitalization portfolios. Moreover, the inclusion of a sufficient number of *qualified* small companies in a small capitalization portfolio that tracks closely a benchmark like the S&P 600 can be a complex task. Nevertheless, the favorable risk/return characteristics of small capitalization portfolios have proven over history to be a sound diversifying asset class for the total portfolio of retirement systems. In the case of small capitalization portfolios, the Division of Investment Services and the Investment Committee will take into consideration the rather unique attributes of these companies before determining their eligibility for addition to any advisor's small capitalization approved list or any future small capitalization master approved list.

Also included in the equity portion of the portfolio are international equities, as defined by Georgia Law (47-20-83). These companies provide increased exposure to some of the more rapidly growing areas of the world as well as those with differing economic cycles.

Corresponding to the domestic equity portion of the fund, passive (index based) management of international equities is utilized as a low cost, low benchmark risk strategy for a core position of international equity assets. Active management of international equities may be utilized based on the belief – similar to domestic equities – that active management can enhance returns while maintaining a conservative investment policy. The benchmarks for the international equity portion of the portfolio shall be the MSCI EAFE and the MSCI ACWI ex. U.S. ex. Iran Free Indices.

It is generally the policy of the Employees' Retirement System of Georgia that all new investments in the actively managed portion of international equities meet similar investment criteria as domestic equities (see above). For international companies, however, historical financial data is not as easy to obtain and may be sparse for some companies, especially those in the emerging markets. Therefore, for some international companies it may be necessary to accept reduced financial history and information as compared to that which is available for domestic equities. Identical to domestic equities, an international company that passes an analysis of the investment criteria is considered qualified for inclusion in the Employees' "Master Approved List of Common Stocks".

In the same manner as domestic equities, if an Investment Advisory firm requests approval to invest in an international company on the Master Approved List, permission by the Investment Committee for buying the respective common stock could be arrived at both expeditiously and with a rather high level of conviction that the company, barring unforeseen economic conditions, will likely prove to be a prudent investment for the Employees' Retirement System of Georgia. If an Investment Advisory firm requests approval to invest in an international company not on the Master Approved List, the company will be subject to additional examination by the Division of Investment Services.

Similar to the caveat relating to small capitalization companies, some securities of foreign companies, especially companies in emerging markets, could be deficient, to a degree, in meeting the aforementioned investment criteria. Nevertheless, the favorable risk/return characteristics of foreign company portfolios have proven over history to be a sound diversifying asset class for the total portfolio of retirement systems. As in the case of small capitalization portfolios, the Division of Investment Services and the Investment Committee will take into consideration the specific attributes of each foreign company before assessing its addition to any advisor's approved list.

Common stocks eligible for investment shall be approved by the Investment Committee. A list of approved stock investments shall be maintained by the Investment Division for each advisor's fund and the in-house funds. Said lists shall at all times meet the investment criteria heretofore referred to and at no time shall any one advisor's list exceed 60 names. No addition to an approved list shall be made without the approval of the Committee except by the inter-meeting procedure of adding a name from the Master Approved List as detailed below.

1. Prior to allowing the addition of a name to an approved list, approval of the Chairman or the Vice Chairman of the Investment Committee or the Chief Investment Officer or Co-Chief Investment Officer of the Division of Investment Services shall be obtained.
2. Stocks added to an index will be reviewed for appropriateness of ownership from a portfolio management perspective in the in-house funds. It is possible for a name to be approved for an in-house portfolio, but not be added to the master approved list.
3. To ensure the ability of the advisors to buy and sell a company's stock as desired, the trading liquidity of the shares will be analyzed. If the normal position size of a stock for an advisor represents a materially large portion of the monthly trading volume in shares of the company under consideration, no more than one advisor may add the name. Should a stock's trading liquidity improve sufficiently after the original approval, other advisors may add the name.
4. Additions under this policy will be confirmed in person at a meeting of the Investment Committee.

When securities of individual companies are prohibited from being purchased as a consequence of State law or by Investment Committee policy, the Division of Investment Services shall maintain a list of those prohibited investments and provide it to all advisors.

Sales of equities are specifically authorized by the Investment Committee with the exception that up to 15% of the equity position of the Retirement System may be sold between monthly Investment Committee meetings without prior approval. However, sales in excess of 5% of the equity position of the Retirement System must be specifically approved by the Chief Investment Officer or Co-Chief Investment Officer of the Division of Investment Services and sales in excess of 10% of the equity position of the Retirement System must be specifically approved by the Chairman or Vice Chairman of the Investment Committee prior to execution by the Investment Division. At the meeting immediately following such a sale, a full report will be made to the Committee as to 1) the price obtained; and 2) whether the funds were reinvested in common stocks or were being held in a short-term investment.

Real Estate

Real Estate assets of the Employees' Retirement System of Georgia are limited and restricted by law solely to any structure occupied by the Retirement System and to real property acquired through judicial foreclosure of mortgage loans owned and held by the Retirement System at time of foreclosure, or by any other judicial or court action that assigns ownership of real property to the Retirement System. It is the policy of the Retirement System to make every effort to sell or otherwise dispose of all such property except that of any structure occupied by the Retirement System within five years of date of acquisition.

Anti-Terrorism

The Board of Trustees, in recognition of laws and sanctions based on national security goals and the fight against terrorism, has adopted an Anti-Terrorism Policy. The Policy prohibits investments in partnerships, corporations, and organizations who provide support, services, assistance, or otherwise associate with terrorists or their agents; who are engaged in international narcotics trafficking or in activities related to the proliferation of weapons of mass destruction; and, who may pose other threats to the national security of the United States.

Accordingly, the Division of Investment Services will not purchase or own any investments that are designated as Foreign Terrorist Organizations by the U.S. Department of State or are listed on the U.S. Department of the Treasury Specially Designated Nationals List.

Proxy Votes

It is the fiduciary responsibility of the Trustees of the Employees' Retirement System of Georgia to vote all proxies solely and exclusively in the best economic interests of the Retirement System. Accordingly, it is the policy of the Employees' Retirement System of Georgia to vote and execute all voting proxies in support of management except where, in the opinion of the Chief Investment Officer or Co-Chief Investment Officer of the Division of Investment Services such a vote would be detrimental to the best interests or rights of the Retirement System. A standing exception to this policy of voting with management is to always vote in favor of confidential proxy balloting as this has been determined to be in the best interests of the Retirement System.

Securities Fraud

The Board, in its fiduciary role, is cognizant of the possibility of securities fraud or illegal activity that may adversely impact the financial interests of the Retirement System. In the event evidence of such activity is detected, the Board should consider appropriate remedies. Accordingly, the Investment Division shall have standing instructions to take reasonable steps to identify and inform itself regarding allegations of securities fraud related to a company in which the Retirement System has a position. If the Investment Division finds that there are reasonable grounds to believe that the Retirement System has suffered a loss as a result of securities fraud, it shall evaluate the extent of the losses sustained by the Retirement System as a result thereof and promptly report its conclusions and recommendations to the Investment Committee of the Board. This will allow the Board to evaluate the potential claim and to determine an appropriate course of action, including the possibility of initiating or participating in litigation.

Personal Integrity

Participation in the affairs of any public body demands a high level of personal integrity and conduct. Especially is this true when wise utilization of the funds of others is involved. Members of the Board of Trustees and their investment staff must discharge their responsibilities without prejudice or favor, avoiding at all times pressures from social issues and any conduct which could create a conflict of interest.

GENERAL STATEMENT OF INVESTMENT POLICY

Employees' Retirement System of Georgia

INVESTMENT OBJECTIVE AND POLICY

The Employees' Retirement System of Georgia (the Retirement System) is governed by a Board of Trustees with broad statutory powers. The investment functions of the Retirement System are vested in this Board as set forth in Georgia laws and in its Investment Committee as set forth in the By-Laws of the said Board of Trustees.

RESPONSIBILITIES OF THE TRUSTEES

By accepting the appointment as trustee, each Trustee acknowledges that he/she is a Fiduciary with responsibilities as described herein.

A fiduciary to the plan must carry out his or her duties in accordance with the plan documents and laws governing the plan. A fiduciary can delegate investment management responsibilities to qualified professional investment personnel. The fiduciary should select all investment services prudently, based solely on the beneficial services to the ultimate beneficiaries of the plan. If a fiduciary or named fiduciary delegates his or her fiduciary responsibility, the fiduciary may still be liable for a breach of fiduciary duty if such delegation is shown to have been based upon influences other than the belief that the plan was best served by the delegation.

Fiduciaries must discharge their duties with respect to the plan:

- solely in the interest of plan participants and beneficiaries;
- for the exclusive purpose of providing benefits to participants and their beneficiaries;
- with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;
- by diversifying the investments of the plan so as to minimize the risk of large losses, unless doing so is clearly not prudent under the circumstances;
- in accordance with the governing plan documents and state laws;
- by being as prudent as the average expert, not simply the average person.

OBJECTIVE

The Board's investment objectives are to provide the greatest possible long-term benefits to members of the Retirement System by maximizing the total rate of return on investment within prudent limits of risk for a retirement fund of this type consistent with the investment return requirement assumed by the actuaries in determining the present and future soundness of the fund.

POLICY

First, Investment Policy is conservative in that it exhibits caution, diversifies risk, uses care in selecting securities and provides for protection against a possible substantial market decline. Secondly, Investment Policy must work toward a goal which maximizes total returns with an acceptable amount of risk to meet actuarial requirements.

Liquidity Needs

As the fund has matured, disbursements have come to exceed contributions. Investment income provides the primary source of liquidity but as the fund continues to mature liquidity needs must be consistently monitored.

Preservation of Capital

Payments from the pension fund, in many if not most instances, constitute the major source of income to retirees and the primary protection against the contingencies of death and disability of active workers. Consequently, the basic policy of the Board is preservation of the capital investment, together with realization of sufficient return to secure and facilitate payment of the statutory benefit requirements of the Retirement System to its beneficiaries.

The Board's policies provide for the utilization of all suitable and prudent avenues of investment authorized under the Georgia Statutes to maintain a high quality, diversified portfolio of investments in conservatively financed companies, the prospects of which are continually reviewed and assessed in the varying economic climate. Consistent performance of the total portfolio is emphasized. Income is expected to be a key part of investment return, not only for the portfolio as a whole but for the equity sector as well. Growth of income is a key objective, particularly in the equity sector.

Diversification

Diversification of the portfolio with respect to types of assets, types of industries, companies within industries, quality of the investment, maturities, geographic areas, etc., is an important limitation of risk. All such diversification is considered within the context of the requirements of the Georgia Statutes and the economic climate at various times to assure the maintenance of a diversified portfolio responsive to changing economic conditions. Diversification by asset types requires investments in the fixed-income area, mainly bonds and mortgages of various types, and equity investments.

Asset Allocation

The investment assets of the Employees' Retirement System are by statute, prohibited from being allocated more than sixty-five percent (65%) to equity securities until July 1, 2010, more than seventy percent (70%) until July 1, 2011 and more than seventy-five percent (75%) thereafter. The Division of Investment Services' policy for implementing these restrictions is to not allocate any new money to equities which would result in the total cost of equities exceeding the then in effect limit of the total cost of all investments. The cost of investments is computed using the original cost of equity securities and the amortized cost of bonds, which means that premiums and discounts are recognized totally over the life of the bonds.

Within these legal restrictions, current policy is to maintain equity exposure on a cost basis between fifty-five percent (55%) and sixty-five percent (65%) and fixed income between thirty-five percent (35%) and forty-five percent (45%).

Rebalancing Asset Classes and Equity Portfolios

Since it is recognized that the fund is long term oriented, investment decisions should be made in order to maximize long term performance and should not be focused on short term movements in the financial markets.

The Investment Committee reviews the asset allocation decision and the equity portfolio mix on a yearly basis. There may, however, be times due to market or other conditions when such rebalancing may need to be considered more often. The investment Committee has authorized the Chief Investment Officer and the Co-Chief Investment Officer to move up to 2% of the market value of the Employees' Retirement System's portfolio among asset classes between Investment Committee meetings.

In looking at the rebalancing, the Committee should focus on the asset allocation between bonds and equity and consider their longer term potential and the legal limits, as well as the needs of the Retirement System.

When looking at individual equity portfolios the Committee should:

- 1) Focus on containing the number of portfolios, as too many portfolios result in a replication of index performance at a high cost. Each portfolio is intended to add value around a risk controlled core.
- 2) Take into account the overall balance of the equity portfolios into sub classes i.e., value, growth, active, passive, and market capitalizations.
- 3) Look at each portfolio versus the equity benchmark as well as versus the applicable benchmark for the specific portfolio in terms of both return and risk. Additional evaluation criteria in the "Statement of Policy on Investment Advisory Services" should also be used.
- 4) Consider additional advisors to address a need in the portfolio while keeping total number of advisors within desired limits. If the decision to add an advisor is reached, the guidelines in the "Statement of Policy on Investment Advisory Services" should be followed.
- 5) Consider the return versus the cost of various investments in order to make the most efficient allocation.
- 6) Make the asset changes to best serve the Retirement System in the upcoming year after consideration of all relevant factors.

Short-Term Investments

It is the policy of the Retirement System to use short-term investments to provide adequate protection against downward market movements and to assist the overall return objectives. Because of the size of both the bond and equity sectors of the portfolio, and because of the essentially long-term nature of the fund, it is not anticipated that major moves will be made into or out of such cash reserves. Under normal circumstances, a reserve of 10% of the combined value of the bond and equity portfolios shall be considered the maximum limit.

Short-term investments may be made in commercial paper, master notes, U. S. Treasury obligations or repurchase agreements with the responsibility resting with the investment staff as to selection of the specific instrument to be used. Commercial paper purchases by the Retirement System shall have a maturity of not more than 180 days and shall be rated P-1 by Moody's Investment Services, Inc. and/or A-1 by Standard & Poor's Corporation. Master notes must be administered by the Custodian Bank and must be an obligation of a corporation whose commercial paper is rated P-1 by Moody's or A-1 by Standard and Poor's. Investments in commercial paper or master notes shall be limited to no more than \$500 million in any one name. Repurchase agreements shall be limited to the purchase of U. S. Treasury or Agency obligations or corporate bonds rated at least "A" by one and no lower than "A" by any major rating agency with a market value in excess of funds advanced.

Fixed-Income Investments

The fixed-income investments include both bonds and mortgages of various types carefully selected on the basis of return, quality, marketability, and overall suitability to the Retirement System's portfolio.

Bonds

It is the policy of the Retirement System that bonds shall represent an important part of the total assets of the Retirement System. The amount of this representation shall vary depending upon economic conditions, interest rates, and relative attractiveness of other available avenues of investment. The Board's policy requires that the bond portfolio be of high quality and chosen with respect to maturity ranges, coupon levels, refunding characteristics, and marketability. Active management of the bond portfolio is encouraged to continually improve the Retirement System's portfolio in terms of quality, marketability, income refunding protection, etc. Market timing, however, should not be implied by a policy of active management. The absolute size of total assets makes market timing impractical.

Investment policy must also be guided by the need to finance long-term liabilities with income return from long-term assets having a high degree of predictability. Quality bonds satisfy this need in that returns from high grade investments in fixed-income securities are highly predictable. In order to meet the quality standards it shall be the policy of the Retirement System to require that new purchases of corporate bonds be restricted to high grade bonds rated at least "A" by one and no lower than "A" by any major rating agency. If a bond in the Retirement System's portfolio is subsequently downgraded to a rating below "A" it shall be placed on a watch list and must be considered as a candidate for sale.

All bond purchases shall have a maturity greater than one year. Purchases of new issues of long-term bonds having a maturity in excess of 15 years are restricted to obligations which have at least 10 years non-refunding protection. Corporate bond investments in any one name shall also be limited to no more than 5% of total assets of the Retirement System.

Sales of bonds are specifically authorized by the Investment Committee with the exception that up to 10% of the bond position of the Retirement System may be sold between monthly Investment Committee meetings without prior approval, provided such sales in excess of 5% of the bond position of the Retirement System must be specifically approved by the Chairman of the Investment Committee prior to execution by the Investment Division. Proceeds from any such sale will be added to the outstanding bond purchase authorization. At the meeting immediately following such a sale, a full report will be made to the Committee as to the price obtained.

Canadian Provincial Obligations

Canadian obligations are legal investments and are not considered to be foreign under Georgia law. However, it has been and is currently the policy of the Retirement System to restrict purchases to new issues payable in U. S. dollars that are issued by the Provinces of Ontario, Quebec and British Columbia. Quality and call protection requirements are the same as set forth above under corporate new issue bonds. Total holdings of said Canadian obligations are limited to no more than 10% of the portfolio, 5% in any one name.

Bond Swap Program

It is the policy of the Retirement System to encourage a bond swap program so as to improve the final return to the Retirement System. Such a bond swap program shall, however, be restricted to bond swap transactions which will improve total return, call protection, quality or maturity distribution. Any other types of swaps must receive prior approval of the Investment Committee. The Division of Investment Services is authorized to make such transactions, provided justification for each swap is in writing and on file with the Division of Investment Services. The following guidelines shall control all bond swap transactions:

1. A bond swap shall be defined as a transaction involving a linked purchase and sale of a corporate, Government agency or Government obligation.
2. There shall be no swap in a security which will result in a reduction in quality below that of an "A" rating by a nationally recognized rating agency.

Private Placements of Georgia Corporations

It is the policy of the Retirement System to invest in obligations of Georgia corporations or in obligations of corporations where the proceeds from such loans are to be spent wholly in the State of Georgia. Said investments must have an investment quality equal to or better than an "A" rated bond. No such investment shall exceed 5% of total assets nor shall the total of said assets exceed 10% of total investment assets of the Retirement System. If not fully guaranteed by the United States Government each such private placement must be specifically approved by the Investment Committee.

Private Placements of U. S. Government Guaranteed Real Estate Securities

The Board is aware of the desirability of contributing to the economic well-being of the State of Georgia by encouraging home ownership. It is the policy of the Retirement System to invest in obligations secured by a first mortgage on investments which promote this goal, provided such obligations are fully guaranteed by the United States Government or are included in a "Pass-Through" security which is fully guaranteed by the United States Government. Yields on such securities should equal or exceed yields currently available on recently offered corporate bonds rated "Aaa." Private Placements of such U. S. Government guaranteed real estate securities shall be purchased and managed under the "Bonds" section of this policy.

Equity Investments

Since fixed-income investments provide only for a current income stream and make no provisions for a hedge against inflation, the policy of the Employees' Retirement System of Georgia provides that such a long-term inflation hedge be obtained by the use of equity investments. This policy provides for flexibility in a changing economic environment and allows for maximization of total return through the judicious use of a combination of both fixed-income and equity investments.

It is the policy of the Employees' Retirement System of Georgia to limit such investments in equities to no more than sixty-five percent (65%) until July 1, 2010, no more than seventy percent (70%) until July 1, 2011 and no more than seventy-five percent (75%) thereafter of the book value of the total invested assets. It shall further be the policy of the Retirement System to limit an investment in the equity of any one corporation to no more than 5% of the book value of the equity portfolio and that such investment shall not exceed 5% of the outstanding equity of the issuing corporation.

In the domestic equity portion of the fund, the Employees' Retirement System of Georgia utilizes different styles of management. Passive (index based) management is utilized as a low cost, low benchmark risk strategy for a core portion of the equity assets. Active management of the common stock portfolio is based on the belief that active management can enhance returns to the fund while maintaining the same conservative investment policy which is the guiding principle behind the investment of all of the Retirement System's assets. The benchmark for the domestic equity portion of the portfolio shall be the Standard & Poor's 1500.

The Retirement System employs Investment Advisory firms to assist in active management of the common stock portfolio. Monitoring of and communications with the Advisors shall be handled in accordance with the guidelines for Performance Objective Monitoring and Communication.

It is the policy of the Employees' Retirement System of Georgia that all new investments in the actively managed portion of equities meet certain investment criteria. The purpose of the criteria is to manage capital risk and opportunity by seeking an assuredness of earnings growth and maintaining a high quality portfolio. The investment criteria can be classified as external or internal. The external criteria refer to the quality ratings provided by the major ratings agencies. The internal ratings refer to the quality ratings the Division of Investment Services assigns to individual companies.

The external and internal ratings are derived from a number of quantitative and qualitative criteria. The criteria include, but are not limited to the following areas:

- The debt level of the company
- The cash flow of the company
- The earnings stability of the company
- The secular growth rate of the company
- The self-financing ability of the company
- The accounting quality and history of the company
- The trend of profit margins and returns on equity of the company
- The degree to which the company has control over its destiny
- The dominant or unique position of the company within its industry
- The complexity and understandability of the corporate profile
- The quality of the company's management including integrity, innovative capacity, motivation, accessibility, and depth

Requiring a company to exceed a specific rating, based upon the comprehensive analysis of a multitude of criteria has proven to be a highly useful aid in selecting companies capable of enduring the ups and downs of business cycles.

After an analysis based on the above criteria, a company may be considered qualified for inclusion on Employees' "Master Approved List of Common Stocks". The Employees' Master Approved List will be a current list of companies maintained by the Division of Investment Services, which are considered to meet a level of risk and potential return suitable for the Employees' Retirement System of Georgia.

If an Investment Advisory firm requests approval to invest in a company on the Master Approved List, permission by the Investment Committee for buying the respective common stock could be arrived at both expeditiously and with a rather high level of conviction that the company, barring unforeseen economic conditions, will likely prove to be a prudent investment for the Employees' Retirement System of Georgia. If an Investment Advisory firm requests approval to invest in a company not on the Master Approved List, the company will be subject to additional scrutiny or examination by the Division of Investment Services.

Small capitalization portfolios with large numbers of rather new, fast growing companies, always face some perceived deficiencies regarding operating history, stability, or quality of management in comparison to larger capitalization portfolios. Moreover, the inclusion of a sufficient number of *qualified* small companies in a small capitalization portfolio that tracks closely a benchmark like the S&P 600 can be a complex task. Nevertheless, the favorable risk/return characteristics of small capitalization portfolios have proven over history to be a sound diversifying asset class for the total portfolio of retirement systems. In the case of small capitalization portfolios, the Division of Investment Services and the Investment Committee will take into consideration the rather unique attributes of these companies before determining their eligibility for addition to any advisor's small capitalization approved list or any future small capitalization master approved list.

Also included in the equity portion of the portfolio are international equities, as defined by Georgia Law (47-20-83). These companies provide increased exposure to some of the more rapidly growing areas of the world as well as those with differing economic cycles.

Corresponding to the domestic equity portion of the fund, passive (index based) management of international equities is utilized as a low cost, low benchmark risk strategy for a core position of international equity assets. Active management of international equities may be utilized based on the belief – similar to domestic equities – that active management can enhance returns while maintaining a conservative investment policy. The benchmarks for the international equity portion of the portfolio shall be the MSCI EAFE and the MSCI ACWI ex. U.S. ex. Iran Free Indices.

It is generally the policy of the Employees' Retirement System of Georgia that all new investments in the actively managed portion of international equities meet similar investment criteria as domestic equities (see above). For international companies, however, historical financial data is not as easy to obtain and may be sparse for some companies, especially those in the emerging markets. Therefore, for some international companies it may be necessary to accept reduced financial history and information as compared to that which is available for domestic equities. Identical to domestic equities, an international company that passes an analysis of the investment criteria is considered qualified for inclusion in the Employees' "Master Approved List of Common Stocks".

In the same manner as domestic equities, if an Investment Advisory firm requests approval to invest in an international company on the Master Approved List, permission by the Investment Committee for buying the respective common stock could be arrived at both expeditiously and with a rather high level of conviction that the company, barring unforeseen economic conditions, will likely prove to be a prudent investment for the Employees' Retirement System of Georgia. If an Investment Advisory firm requests approval to invest in an international company not on the Master Approved List, the company will be subject to additional examination by the Division of Investment Services.

Similar to the caveat relating to small capitalization companies, some securities of foreign companies, especially companies in emerging markets, could be deficient, to a degree, in meeting the aforementioned investment criteria. Nevertheless, the favorable risk/return characteristics of foreign company portfolios have proven over history to be a sound diversifying asset class for the total portfolio of retirement systems. As in the case of small capitalization portfolios, the Division of Investment Services and the Investment Committee will take into consideration the specific attributes of each foreign company before assessing its addition to any advisor's approved list.

Common stocks eligible for investment shall be approved by the Investment Committee. A list of approved stock investments shall be maintained by the Investment Division for each advisor's fund and the in-house funds. Said lists shall at all times meet the investment criteria heretofore referred to and at no time shall any one advisor's list exceed 60 names. No addition to an approved list shall be made without the approval of the Committee except by the inter-meeting procedure of adding a name from the Master Approved List as detailed below.

1. Prior to allowing the addition of a name to an approved list, approval of the Chairman or the Vice Chairman of the Investment Committee or the Chief Investment Officer or Co-Chief Investment Officer of the Division of Investment Services shall be obtained.
2. Stocks added to an index will be reviewed for appropriateness of ownership from a portfolio management perspective in the in-house funds. It is possible for a name to be approved for an in-house portfolio, but not be added to the master approved list.
3. To ensure the ability of the advisors to buy and sell a company's stock as desired, the trading liquidity of the shares will be analyzed. If the normal position size of a stock for an advisor represents a materially large portion of the monthly trading volume in shares of the company under consideration, no more than one advisor may add the name. Should a stock's trading liquidity improve sufficiently after the original approval, other advisors may add the name.
4. Additions under this policy will be confirmed in person at a meeting of the Investment Committee.

When securities of individual companies are prohibited from being purchased as a consequence of State law or by Investment Committee policy, the Division of Investment Services shall maintain a list of those prohibited investments and provide it to all advisors.

Sales of equities are specifically authorized by the Investment Committee with the exception that up to 15% of the equity position of the Retirement System may be sold between monthly Investment Committee meetings without prior approval. However, sales in excess of 5% of the equity position of the Retirement System must be specifically approved by the Chief Investment Officer or Co-Chief Investment Officer of the Division of Investment Services and sales in excess of 10% of the equity position of the Retirement System must be specifically approved by the Chairman or Vice Chairman of the Investment Committee prior to execution by the Investment Division. At the meeting immediately following such a sale, a full report will be made to the Committee as to 1) the price obtained; and 2) whether the funds were reinvested in common stocks or were being held in a short-term investment.

Real Estate

Real Estate assets of the Employees' Retirement System of Georgia are limited and restricted by law solely to any structure occupied by the Retirement System and to real property acquired through judicial foreclosure of mortgage loans owned and held by the Retirement System at time of foreclosure, or by any other judicial or court action that assigns ownership of real property to the Retirement System. It is the policy of the Retirement System to make every effort to sell or otherwise dispose of all such property except that of any structure occupied by the Retirement System within five years of date of acquisition.

Proxy Votes

It is the fiduciary responsibility of the Trustees of the Employees' Retirement System of Georgia to vote all proxies solely and exclusively in the best economic interests of the Retirement System. Accordingly, it is the policy of the Employees' Retirement System of Georgia to vote and execute all voting proxies in support of management except where, in the opinion of the Chief Investment Officer or Co-Chief Investment Officer of the Division of Investment Services such a vote would be detrimental to the best interests or rights of the Retirement System. A standing exception to this policy of voting with management is to always vote in favor of confidential proxy balloting as this has been determined to be in the best interests of the Retirement System.

Securities Fraud

The Board, in its fiduciary role, is cognizant of the possibility of securities fraud or illegal activity that may adversely impact the financial interests of the Retirement System. In the event evidence of such activity is detected, the Board should consider appropriate remedies. Accordingly, the Investment Division shall have standing instructions to take reasonable steps to identify and inform itself regarding allegations of securities fraud related to a company in which the Retirement System has a position. If the Investment Division finds that there are reasonable grounds to believe that the Retirement System has suffered a loss as a result of securities fraud, it shall evaluate the extent of the losses sustained by the Retirement System as a result thereof and promptly report its conclusions and recommendations to the Investment Committee of the Board. This will allow the Board to evaluate the potential claim and to determine an appropriate course of action, including the possibility of initiating or participating in litigation.

Personal Integrity

Participation in the affairs of any public body demands a high level of personal integrity and conduct. Especially is this true when wise utilization of the funds of others is involved. Members of the Board of Trustees and their investment staff must discharge their responsibilities without prejudice or favor, avoiding at all times pressures from social issues and any conduct which could create a conflict of interest.

Adopted as of April 16, 2009 to be effective April 21, 2009

GENERAL STATEMENT OF INVESTMENT POLICY

Employees' Retirement System of Georgia

INVESTMENT OBJECTIVE AND POLICY

The Employees' Retirement System of Georgia (the Retirement System) is governed by a Board of Trustees with broad statutory powers. The investment functions of the Retirement System are vested in this Board as set forth in Georgia laws and in its Investment Committee as set forth in the By-Laws of the said Board of Trustees.

RESPONSIBILITIES OF THE TRUSTEES

By accepting the appointment as trustee, each Trustee acknowledges that he/she is a Fiduciary with responsibilities as described herein.

A fiduciary to the plan must carry out his or her duties in accordance with the plan documents and laws governing the plan. A fiduciary can delegate investment management responsibilities to qualified professional investment personnel. The fiduciary should select all investment services prudently, based solely on the beneficial services to the ultimate beneficiaries of the plan. If a fiduciary or named fiduciary delegates his or her fiduciary responsibility, the fiduciary may still be liable for a breach of fiduciary duty if such delegation is shown to have been based upon influences other than the belief that the plan was best served by the delegation.

Fiduciaries must discharge their duties with respect to the plan:

- solely in the interest of plan participants and beneficiaries;
- for the exclusive purpose of providing benefits to participants and their beneficiaries;
- with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;
- by diversifying the investments of the plan so as to minimize the risk of large losses, unless doing so is clearly not prudent under the circumstances;
- in accordance with the governing plan documents and state laws;
- by being as prudent as the average expert, not simply the average person.

OBJECTIVE

The Board's investment objectives are to provide the greatest possible long-term benefits to members of the Retirement System by maximizing the total rate of return on investment within prudent limits of risk for a retirement fund of this type consistent with the investment return requirement assumed by the actuaries in determining the present and future soundness of the fund.

POLICY

First, Investment Policy is conservative in that it exhibits caution, diversifies risk, uses care in selecting securities and provides for protection against a possible substantial market decline. Secondly, Investment Policy must work toward a goal which maximizes total returns with an acceptable amount of risk to meet actuarial requirements.

Liquidity Needs

As the fund has matured, disbursements have come to exceed contributions. Investment income provides the primary source of liquidity but as the fund continues to mature liquidity needs must be consistently monitored.

Preservation of Capital

Payments from the pension fund, in many if not most instances, constitute the major source of income to retirees and the primary protection against the contingencies of death and disability of active workers. Consequently, the basic policy of the Board is preservation of the capital investment, together with realization of sufficient return to secure and facilitate payment of the statutory benefit requirements of the Retirement System to its beneficiaries.

The Board's policies provide for the utilization of all suitable and prudent avenues of investment authorized under the Georgia Statutes to maintain a high quality, diversified portfolio of investments in conservatively financed companies, the prospects of which are continually reviewed and assessed in the varying economic climate. Consistent performance of the total portfolio is emphasized. Income is expected to be a key part of investment return, not only for the portfolio as a whole but for the equity sector as well. Growth of income is a key objective, particularly in the equity sector.

Diversification

Diversification of the portfolio with respect to types of assets, types of industries, companies within industries, quality of the investment, maturities, geographic areas, etc., is an important limitation of risk. All such diversification is considered within the context of the requirements of the Georgia Statutes and the economic climate at various times to assure the maintenance of a diversified portfolio responsive to changing economic conditions. Diversification by asset types requires investments in the fixed-income area, mainly bonds and mortgages of various types, and equity investments.

Asset Allocation

The investment assets of the Employees' Retirement System of Georgia are, by statute, prohibited from being allocated more than 60% to equity securities. The Division of Investment Services' policy for implementing this statute is to not allocate any new money to equities which would result in the total cost of equities exceeding 60% of the total cost of all investments. Also by statute, the Retirement System can invest no more than 15% of the assets in obligations of foreign corporations as defined in the statute, again based on the cost of investments and the same policy for implementation as for equity percentages. The cost of investments is computed using the original cost of equity securities and the amortized cost of bonds, which means that premiums and discounts are recognized ratably over the life of the bonds purchased.

Rebalancing Asset Classes and Equity Portfolios

Since it is recognized that the fund is long term oriented, investment decisions should be made in order to maximize long term performance and should not be focused on short term movements in the financial markets.

The Investment Committee reviews the asset allocation decision and the equity portfolio mix on a yearly basis. There may, however, be times due to market or other conditions when such rebalancing may need to be considered more often. The investment Committee has authorized the Chief Investment Officer and the Co-Chief Investment Officer to move up to 2% of the market value of the Employees' Retirement System's portfolio among asset classes between Investment Committee meetings.

In looking at the rebalancing, the Committee should focus on the asset allocation between bonds and equity and consider their longer term potential and the legal limits, as well as the needs of the Retirement System.

When looking at individual equity portfolios the Committee should:

- 1) Focus on containing the number of portfolios, as too many portfolios result in a replication of index performance at a high cost. Each portfolio is intended to add value around a risk controlled core.
- 2) Take into account the overall balance of the equity portfolios into sub classes i.e., value, growth, active, passive, and market capitalizations.
- 3) Look at each portfolio versus the equity benchmark as well as versus the applicable benchmark for the specific portfolio in terms of both return and risk. Additional evaluation criteria in the "Statement of Policy on Investment Advisory Services" should also be used.
- 4) Consider additional advisors to address a need in the portfolio while keeping total number of advisors within desired limits. If the decision to add an advisor is reached, the guidelines in the "Statement of Policy on Investment Advisory Services" should be followed.
- 5) Consider the return versus the cost of various investments in order to make the most efficient allocation.
- 6) Make the asset changes to best serve the Retirement System in the upcoming year after consideration of all relevant factors.

Short-Term Investments

It is the policy of the Retirement System to use short-term investments to provide adequate protection against downward market movements and to assist the overall return objectives. Because of the size of both the bond and equity sectors of the portfolio, and because of the essentially long-term nature of the fund, it is not anticipated that major moves will be made into or out of such cash reserves. Under normal circumstances, a reserve of 10% of the combined value of the bond and equity portfolios shall be considered the maximum limit.

Short-term investments may be made in commercial paper, master notes, U. S. Treasury obligations or repurchase agreements with the responsibility resting with the investment staff as to selection of the specific instrument to be used. Commercial paper purchases by the Retirement System shall have a maturity of not more than 180 days and shall be rated P-1 by Moody's Investment Services, Inc. and/or A-1 by Standard & Poor's Corporation. Master notes must be administered by the Custodian Bank and must be an obligation of a corporation whose commercial paper is rated P-1 by Moody's or A-1 by Standard and Poor's. Investments in commercial paper or master notes shall be limited to no more than \$500 million in any one name. Repurchase agreements shall be limited to the purchase of U. S. Treasury or Agency obligations or corporate bonds rated at least "A" by one and no lower than "A" by any major rating agency with a market value in excess of funds advanced.

Fixed-Income Investments

The fixed-income investments include both bonds and mortgages of various types carefully selected on the basis of return, quality, marketability, and overall suitability to the Retirement System's portfolio.

Bonds

It is the policy of the Retirement System that bonds shall represent an important part of the total assets of the Retirement System. The amount of this representation shall vary depending upon economic conditions, interest rates, and relative attractiveness of other available avenues of investment. The Board's policy requires that the bond portfolio be of high quality and chosen with respect to maturity ranges, coupon levels, refunding characteristics, and marketability. Active management of the bond portfolio is encouraged to continually improve the Retirement System's portfolio in terms of quality, marketability, income refunding protection, etc. Market timing, however, should not be implied by a policy of active management. The absolute size of total assets makes market timing impractical.

Investment policy must also be guided by the need to finance long-term liabilities with income return from long-term assets having a high degree of predictability. Quality bonds satisfy this need in that returns from high grade investments in fixed-income securities are highly predictable. In order to meet the quality standards it shall be the policy of the Retirement System to require that new purchases of corporate bonds be restricted to high grade bonds rated at least "A" by one and no lower than "A" by any major rating agency. If a bond in the Retirement System's portfolio is subsequently downgraded to a rating below "A" it shall be placed on a watch list and must be considered as a candidate for sale.

All bond purchases shall have a maturity greater than one year. Purchases of new issues of long-term bonds having a maturity in excess of 15 years are restricted to obligations which have at least 10 years non-refunding protection. Corporate bond investments in any one name shall also be limited to no more than 5% of total assets of the Retirement System.

Sales of bonds are specifically authorized by the Investment Committee with the exception that up to 10% of the bond position of the Retirement System may be sold between monthly Investment Committee meetings without prior approval, provided such sales in excess of 5% of the bond position of the Retirement System must be specifically approved by the Chairman of the Investment Committee prior to execution by the Investment Division. Proceeds from any such sale will be added to the outstanding bond purchase authorization. At the meeting immediately following such a sale, a full report will be made to the Committee as to the price obtained.

Canadian Provincial Obligations

Canadian obligations are legal investments and are not considered to be foreign under Georgia law. However, it has been and is currently the policy of the Retirement System to restrict purchases to new issues payable in U. S. dollars that are issued by the Provinces of Ontario, Quebec and British Columbia. Quality and call protection requirements are the same as set forth above under corporate new issue bonds. Total holdings of said Canadian obligations are limited to no more than 10% of the portfolio, 5% in any one name.

Bond Swap Program

It is the policy of the Retirement System to encourage a bond swap program so as to improve the final return to the Retirement System. Such a bond swap program shall, however, be restricted to bond swap transactions which will improve total return, call protection, quality or maturity distribution. Any other types of swaps must receive prior approval of the Investment Committee. The Division of Investment Services is authorized to make such transactions, provided justification for each swap is in writing and on file with the Division of Investment Services. The following guidelines shall control all bond swap transactions:

1. A bond swap shall be defined as a transaction involving a linked purchase and sale of a corporate, Government agency or Government obligation.
2. There shall be no swap in a security which will result in a reduction in quality below that of an "A" rating by a nationally recognized rating agency.

Private Placements of Georgia Corporations

It is the policy of the Retirement System to invest in obligations of Georgia corporations or in obligations of corporations where the proceeds from such loans are to be spent wholly in the State of Georgia. Said investments must have an investment quality equal to or better than an "A" rated bond. No such investment shall exceed 5% of total assets nor shall the total of said assets exceed 10% of total investment assets of the Retirement System. If not fully guaranteed by the United States Government each such private placement must be specifically approved by the Investment Committee.

Private Placements of U. S. Government Guaranteed Real Estate Securities

The Board is aware of the desirability of contributing to the economic well-being of the State of Georgia by encouraging home ownership. It is the policy of the Retirement System to invest in obligations secured by a first mortgage on investments which promote this goal, provided such obligations are fully guaranteed by the United States Government or are included in a "Pass-Through" security which is fully guaranteed by the United States Government. Yields on such securities should equal or exceed yields currently available on recently offered corporate bonds rated "Aaa." Private Placements of such U. S. Government guaranteed real estate securities shall be purchased and managed under the "Bonds" section of this policy.

Equity Investments

Since fixed-income investments provide only for a current income stream and make no provisions for a hedge against inflation, the policy of the Employees' Retirement System of Georgia provides that such a long-term inflation hedge be obtained by the use of equity investments. This policy provides for flexibility in a changing economic environment and allows for maximization of total return through the judicious use of a combination of both fixed-income and equity investments.

It is the policy of the Employees' Retirement System of Georgia to limit such investments in equities to no more than 60% of the book value of the total invested assets. It shall further be the policy of the Retirement System to limit an investment in the equity of any one corporation to no more than 5% of the book value of the equity portfolio and that such investment shall not exceed 5% of the outstanding equity of the issuing corporation.

In the domestic equity portion of the fund, the Employees' Retirement System of Georgia utilizes different styles of management. Passive (index based) management is utilized as a low cost, low benchmark risk strategy for a core portion of the equity assets. Active management of the common stock portfolio is based on the belief that active management can enhance returns to the fund while maintaining the same conservative investment policy which is the guiding principle behind the investment of all of the Retirement System's assets. The benchmark for the domestic equity portion of the portfolio shall be the Standard & Poor's 1500.

The Retirement System employs Investment Advisory firms to assist in active management of the common stock portfolio. Monitoring of and communications with the Advisors shall be handled in accordance with the guidelines for Performance Objective Monitoring and Communication.

It is the policy of the Employees' Retirement System of Georgia that all new investments in the actively managed portion of equities meet certain investment criteria. The purpose of the criteria is to manage capital risk and opportunity by seeking an assuredness of earnings growth and maintaining a high quality portfolio. The investment criteria can be classified as external or internal. The external criteria refer to the quality ratings provided by the major ratings agencies. The internal ratings refer to the quality ratings the Division of Investment Services assigns to individual companies.

The external and internal ratings are derived from a number of quantitative and qualitative criteria. The criteria include, but are not limited to the following areas:

- The debt level of the company
- The cash flow of the company
- The earnings stability of the company
- The secular growth rate of the company
- The self-financing ability of the company
- The accounting quality and history of the company
- The trend of profit margins and returns on equity of the company
- The degree to which the company has control over its destiny
- The dominant or unique position of the company within its industry
- The complexity and understandability of the corporate profile
- The quality of the company's management including integrity, innovative capacity, motivation, accessibility, and depth

Requiring a company to exceed a specific rating, based upon the comprehensive analysis of a multitude of criteria has proven to be a highly useful aid in selecting companies capable of enduring the ups and downs of business cycles.

After an analysis based on the above criteria, a company may be considered qualified for inclusion on Employees' "Master Approved List of Common Stocks". The Employees' Master Approved List will be a current list of companies maintained by the Division of Investment Services, which are considered to meet a level of risk and potential return suitable for the Employees' Retirement System of Georgia.

If an Investment Advisory firm requests approval to invest in a company on the Master Approved List, permission by the Investment Committee for buying the respective common stock could be arrived at both expeditiously and with a rather high level of conviction that the company, barring unforeseen economic conditions, will likely prove to be a prudent investment for the Employees' Retirement System of Georgia. If an Investment Advisory firm requests approval to invest in a company not on the Master Approved List, the company will be subject to additional scrutiny or examination by the Division of Investment Services.

Small capitalization portfolios with large numbers of rather new, fast growing companies, always face some perceived deficiencies regarding operating history, stability, or quality of management in comparison to larger capitalization portfolios. Moreover, the inclusion of a sufficient number of *qualified* small companies in a small capitalization portfolio that tracks closely a benchmark like the S&P 600 can be a complex task. Nevertheless, the favorable risk/return characteristics of small capitalization portfolios have proven over history to be a sound diversifying asset class for the total portfolio of retirement systems. In the case of small capitalization portfolios, the Division of Investment Services and the Investment Committee will take into consideration the rather unique attributes of these companies before determining their eligibility for addition to any advisor's small capitalization approved list or any future small capitalization master approved list.

Also included in the equity portion of the portfolio are international equities, as defined by Georgia Law (47-20-83). It is the policy of the Employees' Retirement System of Georgia that such international equities may comprise no more than 15% of the book value of total invested assets. These companies provide increased exposure to some of the more rapidly growing areas of the world as well as those with differing economic cycles.

Corresponding to the domestic equity portion of the fund, passive (index based) management of international equities is utilized as a low cost, low benchmark risk strategy for a core position of international equity assets. Active management of international equities may be utilized based on the belief – similar to domestic equities – that active management can enhance returns while maintaining a conservative investment policy. The benchmarks for the international equity portion of the portfolio shall be the MSCI EAFE and the MSCI ACWI ex. U.S. Free Indices.

It is generally the policy of the Employees' Retirement System of Georgia that all new investments in the actively managed portion of international equities meet similar investment criteria as domestic equities (see above). For international companies, however, historical financial data is not as easy to obtain and may be sparse for some companies, especially those in the emerging markets. Therefore, for some international companies it may be necessary to accept reduced financial history and information as compared to that which is available for domestic equities. Identical to domestic equities, an international company that passes an analysis of the investment criteria is considered qualified for inclusion in the Employees' "Master Approved List of Common Stocks".

In the same manner as domestic equities, if an Investment Advisory firm requests approval to invest in an international company on the Master Approved List, permission by the Investment Committee for buying the respective common stock could be arrived at both expeditiously and with a rather high level of conviction that the company, barring unforeseen economic conditions, will likely prove to be a prudent investment for the Employees' Retirement System of Georgia. If an Investment Advisory firm requests approval to invest in an international company not on the Master Approved List, the company will be subject to additional examination by the Division of Investment Services.

Similar to the caveat relating to small capitalization companies, some securities of foreign companies, especially companies in emerging markets, could be deficient, to a degree, in meeting the aforementioned investment criteria. Nevertheless, the favorable risk/return characteristics of foreign company portfolios have proven over history to be a sound diversifying asset class for the total portfolio of retirement systems. As in the case of small capitalization portfolios, the Division of Investment Services and the Investment Committee will take into consideration the specific attributes of each foreign company before assessing its addition to any advisor's approved list.

Common stocks eligible for investment shall be approved by the Investment Committee. A list of approved stock investments shall be maintained by the Investment Division for each advisor's fund and the in-house funds. Said lists shall at all times meet the investment criteria heretofore referred to and at no time shall any one advisor's list exceed 60 names. No addition to an approved list shall be made without the approval of the Committee except by the inter-meeting procedure of adding a name from the Master Approved List as detailed below.

1. Prior to allowing the addition of a name to an approved list, approval of the Chairman or the Vice Chairman of the Investment Committee or the Chief Investment Officer or Co-Chief Investment Officer of the Division of Investment Services shall be obtained.
2. Stocks added to an index will be reviewed for appropriateness of ownership from a portfolio management perspective in the in-house funds. It is possible for a name to be approved for an in-house portfolio, but not be added to the master approved list.
3. To ensure the ability of the advisors to buy and sell a company's stock as desired, the trading liquidity of the shares will be analyzed. If the normal position size of a stock for an advisor represents a materially large portion of the monthly trading volume in shares of the company under consideration, no more than one advisor may add the name. Should a stock's trading liquidity improve sufficiently after the original approval, other advisors may add the name.
4. Additions under this policy will be confirmed in person at a meeting of the Investment Committee.

When securities of individual companies are prohibited from being purchased as a consequence of State law or by Investment Committee policy, the Division of Investment Services shall maintain a list of those prohibited investments and provide it to all advisors.

Sales of equities are specifically authorized by the Investment Committee with the exception that up to 15% of the equity position of the Retirement System may be sold between monthly Investment Committee meetings without prior approval. However, sales in excess of 5% of the equity position of the Retirement System must be specifically approved by the Chief Investment Officer or Co-Chief Investment Officer of the Division of Investment Services and sales in excess of 10% of the equity position of the Retirement System must be specifically approved by the Chairman or Vice Chairman of the Investment Committee prior to execution by the Investment Division. At the meeting immediately following such a sale, a full report will be made to the Committee as to 1) the price obtained; and 2) whether the funds were reinvested in common stocks or were being held in a short-term investment.

Real Estate

Real Estate assets of the Employees' Retirement System of Georgia are limited and restricted by law solely to any structure occupied by the Retirement System and to real property acquired through judicial foreclosure of mortgage loans owned and held by the Retirement System at time of foreclosure, or by any other judicial or court action that assigns ownership of real property to the Retirement System. It is the policy of the Retirement System to make every effort to sell or otherwise dispose of all such property except that of any structure occupied by the Retirement System within five years of date of acquisition.

Proxy Votes

It is the fiduciary responsibility of the Trustees of the Employees' Retirement System of Georgia to vote all proxies solely and exclusively in the best economic interests of the Retirement System. Accordingly, it is the policy of the Employees' Retirement System of Georgia to vote and execute all voting proxies in support of management except where, in the opinion of the Chief Investment Officer or Co-Chief Investment Officer of the Division of Investment Services such a vote would be detrimental to the best interests or rights of the Retirement System. A standing exception to this policy of voting with management is to always vote in favor of confidential proxy balloting as this has been determined to be in the best interests of the Retirement System.

Securities Fraud

The Board, in its fiduciary role, is cognizant of the possibility of securities fraud or illegal activity that may adversely impact the financial interests of the Retirement System. In the event evidence of such activity is detected, the Board should consider appropriate remedies. Accordingly, the Investment Division shall have standing instructions to take reasonable steps to identify and inform itself regarding allegations of securities fraud related to a company in which the Retirement System has a position. If the Investment Division finds that there are reasonable grounds to believe that the Retirement System has suffered a loss as a result of securities fraud, it shall evaluate the extent of the losses sustained by the Retirement System as a result thereof and promptly report its conclusions and recommendations to the Investment Committee of the Board. This will allow the Board to evaluate the potential claim and to determine an appropriate course of action, including the possibility of initiating or participating in litigation.

Personal Integrity

Participation in the affairs of any public body demands a high level of personal integrity and conduct. Especially is this true when wise utilization of the funds of others is involved. Members of the Board of Trustees and their investment staff must discharge their responsibilities without prejudice or favor, avoiding at all times pressures from social issues and any conduct which could create a conflict of interest.

Adopted as of June 19, 2008 to be effective July 1, 2008

GENERAL STATEMENT OF INVESTMENT POLICY

Employees' Retirement System of Georgia

INVESTMENT OBJECTIVE AND POLICY

The Employees' Retirement System of Georgia (the Retirement System) is governed by a Board of Trustees with broad statutory powers. The investment functions of the Retirement System are vested in this Board as set forth in Georgia laws and in its Investment Committee as set forth in the By-Laws of the said Board of Trustees.

RESPONSIBILITIES OF THE TRUSTEES

By accepting the appointment as trustee, each Trustee acknowledges that he/she is a Fiduciary with responsibilities as described herein.

A fiduciary to the plan must carry out his or her duties in accordance with the plan documents and laws governing the plan. A fiduciary can delegate investment management responsibilities to qualified professional investment personnel. The fiduciary should select all investment services prudently, based solely on the beneficial services to the ultimate beneficiaries of the plan. If a fiduciary or named fiduciary delegates his or her fiduciary responsibility, the fiduciary may still be liable for a breach of fiduciary duty if such delegation is shown to have been based upon influences other than the belief that the plan was best served by the delegation.

Fiduciaries must discharge their duties with respect to the plan:

- solely in the interest of plan participants and beneficiaries;
- for the exclusive purpose of providing benefits to participants and their beneficiaries;
- with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;
- by diversifying the investments of the plan so as to minimize the risk of large losses, unless doing so is clearly not prudent under the circumstances;
- in accordance with the governing plan documents and state laws;
- by being as prudent as the average expert, not simply the average person.

OBJECTIVE

The Board's investment objectives are to provide the greatest possible long-term benefits to members of the Retirement System by maximizing the total rate of return on investment within prudent limits of risk for a retirement fund of this type consistent with the investment return requirement assumed by the actuaries in determining the present and future soundness of the fund.

POLICY

First, Investment Policy is conservative in that it exhibits caution, diversifies risk, uses care in selecting securities and provides for protection against a possible substantial market decline. Secondly, Investment Policy must work toward a goal which maximizes total returns with an acceptable amount of risk to meet actuarial requirements.

Liquidity Needs

As the fund has matured, disbursements have come to exceed contributions. Investment income provides the primary source of liquidity but as the fund continues to mature liquidity needs must be consistently monitored.

Preservation of Capital

Payments from the pension fund, in many if not most instances, constitute the major source of income to retirees and the primary protection against the contingencies of death and disability of active workers. Consequently, the basic policy of the Board is preservation of the capital investment, together with realization of sufficient return to secure and facilitate payment of the statutory benefit requirements of the Retirement System to its beneficiaries.

The Board's policies provide for the utilization of all suitable and prudent avenues of investment authorized under the Georgia Statutes to maintain a high quality, diversified portfolio of investments in conservatively financed companies, the prospects of which are continually reviewed and assessed in the varying economic climate. Consistent performance of the total portfolio is emphasized. Income is expected to be a key part of investment return, not only for the portfolio as a whole but for the equity sector as well. Growth of income is a key objective, particularly in the equity sector.

Diversification

Diversification of the portfolio with respect to types of assets, types of industries, companies within industries, quality of the investment, maturities, geographic areas, etc., is an important limitation of risk. All such diversification is considered within the context of the requirements of the Georgia Statutes and the economic climate at various times to assure the maintenance of a diversified portfolio responsive to changing economic conditions. Diversification by asset types requires investments in the fixed-income area, mainly bonds and mortgages of various types, and equity investments.

Asset Allocation

The investment assets of the Employees' Retirement System of Georgia are, by statute, prohibited from being allocated more than 60% to equity securities. The Division of Investment Services' policy for implementing this statute is to not allocate any new money to equities which would result in the total cost of equities exceeding 60% of the total cost of all investments. Also by law, the Retirement System can invest no more than 15% of the assets in obligations of foreign corporations as defined in the statute, again based on the cost of investments and the same policy for implementation as for equity percentages. The cost of investments is computed using the original cost of equity securities and the amortized cost of bonds, which means that gains and losses on bond swaps and premiums and discounts are recognized ratably over the life of the bonds purchased.

Rebalancing Asset Classes and Equity Portfolios

Since it is recognized that the fund is long term oriented, investment decisions should be made in order to maximize long term performance and should not be focused on short term movements in the financial markets.

The Investment Committee reviews the asset allocation decision and the equity portfolio mix on a yearly basis. There may, however, be infrequent times due to market or other conditions when such rebalancing may need to be considered more often. The Investment Committee has authorized the Chief Investment Officer and the Co-Chief Investment Officer to move up to 2% of the market value of the Employees' Retirement System's portfolio among asset classes between Investment Committee meetings.

In looking at the rebalancing, the Committee should focus on the asset allocation between bonds and equity and consider their longer term potential and the legal limits, as well as the needs of the Retirement System.

When looking at individual equity portfolios the Committee should:

- 1) Focus on containing the number of portfolios, as too many portfolios result in a replication of index performance at a high cost. Each portfolio is intended to add value around a risk controlled core.
- 2) Take into account the overall balance of the equity portfolios into sub classes i.e., value, growth, active, passive, and market capitalizations.
- 3) Look at each portfolio versus the equity benchmark as well as versus the applicable benchmark for the specific portfolio in terms of both return and risk. Additional evaluation criteria in the "Statement of Policy on Investment Advisory Services" should also be used.
- 4) Consider additional advisors to address a need in the portfolio while keeping total number of advisors within desired limits. If the decision to add an advisor is reached, the guidelines in the "Statement of Policy on Investment Advisor Services" should be followed.
- 5) Consider the return versus the cost of various investments in order to make the most efficient allocation.
- 6) Make the asset changes to best serve the Retirement System in the upcoming year after consideration of all relevant factors.

Short-Term Investments

It is the policy of the Retirement System to use short-term investments to provide adequate protection against downward market movements and to assist the overall return objectives. Because of the size of both the bond and equity sectors of the portfolio, and because of the essentially long-term nature of the fund, it is not anticipated that major moves will be made into or out of such cash reserves. Under normal circumstances, a reserve of 10% of the combined value of the bond and equity portfolios shall be considered the maximum limit.

Short-term investments may be made in commercial paper, master notes, U. S. Treasury obligations or repurchase agreements with the responsibility resting with the investment staff as to selection of the specific instrument to be used. Commercial paper purchases by the Retirement System shall have a maturity of not more than 180 days and shall be rated P-1 by Moody's Investment Services, Inc. and/or A-1 by Standard & Poor's Corporation. Master notes must be administered by the Custodian Bank and must be an obligation of a corporation whose commercial paper is rated P-1 by Moody's or A-1 by Standard and Poor's. Investments in commercial paper or master notes shall be limited to no more than \$100 million in any one name. Repurchase agreements shall be limited to the purchase of U. S. Treasury or Agency obligations or corporate bonds rated at least "A" by one and no lower than "A" by any major rating agency with a market value in excess of funds advanced.

Fixed-Income Investments

The fixed-income investments include both bonds and mortgages of various types carefully selected on the basis of return, quality, marketability, and overall suitability to the Retirement System's portfolio.

Bonds

It is the policy of the Retirement System that bonds shall represent an important part of the total assets of the Retirement System. The amount of this representation shall vary depending upon economic conditions, interest rates, and relative attractiveness of other available avenues of investment. The Board's policy requires that the bond portfolio be of high quality and chosen with respect to maturity ranges, coupon levels, refunding characteristics, and marketability. Active management of the bond portfolio is encouraged to continually improve the Retirement System's portfolio in terms of quality, marketability, income refunding protection, etc. Market timing, however, should not be implied by a policy of active management. The absolute size of total assets makes market timing impractical.

Investment policy must also be guided by the need to finance long-term liabilities with income return from long-term assets having a high degree of predictability. Quality bonds satisfy this need in that returns from high grade investments in fixed-income securities are highly predictable. In order to meet the quality standards it shall be the policy of the Retirement System to require that new purchases of corporate bonds be restricted to high grade bonds rated at least "A" by one and no lower than "A" by any major rating agency. If a bond in the Retirement System's portfolio is subsequently downgraded to a rating below "A" it shall be placed on a watch list and must be considered as a candidate for sale.

All bond purchases shall have a maturity greater than one year. Purchases of new issues of long-term bonds having a maturity in excess of 15 years are restricted to obligations which have at least 10 years non-refunding protection. Corporate bond investments in any one name shall also be limited to no more than 5% of total assets of the Retirement System.

Sales of bonds are specifically authorized by the Investment Committee with the exception that up to 10% of the bond position of the Retirement System may be sold between monthly Investment Committee meetings without prior approval, provided such sales in excess of 5% of the bond position of the Retirement System must be specifically approved by the Chairman of the Investment Committee prior to execution by the Investment Division. Proceeds from any such sale will be added to the outstanding bond purchase authorization. At the meeting immediately following such a sale, a full report will be made to the Committee as to the price obtained.

Canadian Provincial Obligations

Canadian obligations are legal investments under the law. However, it has been and is currently the policy of the Retirement System to restrict purchases to new issues payable in U. S. dollars that are issued by the Provinces of Ontario, Quebec and British Columbia. Quality and call protection requirements are the same as set forth above under corporate new issue bonds. Total holdings of said Canadian obligations are limited to no more than 10% of the portfolio, 5% in any one name.

Bond Exchange Program

It is the policy of the Retirement System to encourage a bond exchange program so as to improve the final return to the Retirement System. Such a bond exchange program shall, however, be restricted to bond exchanges and bond swap transactions which will improve total return, call protection, quality or maturity distribution. Any other types of exchanges must receive prior approval of the Investment Committee. The Division of Investment Services is authorized to make such transactions, provided justification for each swap is in writing and on file with the Division of Investment Services. The following guidelines shall control all bond exchange (bond swap) transactions:

- (1) A bond swap shall be defined as a transaction involving a linked purchase and sale of a corporate or Government obligation.
- (2) There shall be no swap in a security which will result in a reduction in quality below that of an "A" rating by a nationally recognized rating agency.
- (3) Amortization of gains and losses shall be by the straight-line method over the life of the purchased bond.

Private Placements of Georgia Corporations

It is the policy of the Retirement System to invest in obligations of Georgia corporations or in obligations of corporations where the proceeds from such loans are to be spent wholly in the State of Georgia. Said investments must have an investment quality equal to or better than an "A" rated bond. No such investment shall exceed 5% of total assets nor shall the total of said assets exceed 10% of total investment assets of the Retirement System. If not fully guaranteed by the United States Government each such private placement must be specifically approved by the Investment Committee.

Private Placements of U. S. Government Guaranteed Real Estate Securities

The Board is aware of the desirability of contributing to the economic well-being of the State of Georgia by encouraging home ownership and the construction of such facilities as apartments, nursing homes, and housing for the elderly. It is the policy of the Retirement System to invest in obligations secured by a first mortgage on such facilities provided such obligations are fully guaranteed by the United States Government or are included in a "Pass-Through" security which is fully guaranteed by the United States Government. Yields on such securities should equal or exceed yields currently available on recently offered corporate bonds rated Aaa. Private Placements of such U. S. Government guaranteed real estate securities shall be purchased and managed under the "Bonds" section of this policy.

Mortgages

Mortgage investments shall include those not guaranteed by the U. S. Government and pass-through securities issued against specific pools of mortgages. The amount of such investments shall depend upon economic conditions, interest rates, and relative attractiveness of other available avenues of investments and shall be limited in amount to no more than 10% of total assets, 1% in any one loan. It shall further be the policy of the Retirement System to limit such investments to mortgage loans or securities secured by first mortgages on improved real property located in the State of Georgia having a loan-to-value ratio no higher than 75%. All mortgage investment shall be of high quality and must be specifically approved by the Investment Committee.

Equity Investments

Since fixed-income investments provide only for a current income stream and make no provisions for a hedge against inflation, the policy of the Employees' Retirement System of Georgia provides that such a long-term inflation hedge be obtained by the use of equity investments. This policy provides for flexibility in a changing economic environment and allows for maximization of total return through the judicious use of a combination of both fixed-income and equity investments.

It is the policy of the Employees' Retirement System of Georgia to limit such investments in equities to no more than 60% of the book value of the total invested assets. It shall further be the policy of the Retirement System to limit an investment in the equity of any one corporation to no more than 5% of the book value of the equity portfolio and that such investment shall not exceed 5% of the outstanding equity of the issuing corporation.

In the domestic equity portion of the fund, the Employees' Retirement System of Georgia utilizes different styles of management. Passive (index based) management is utilized as a low cost, low benchmark risk strategy for a core portion of the equity assets. Active management of the common stock portfolio is based on the belief that active management can enhance returns to the fund while maintaining the same conservative investment policy which is the guiding principle behind the investment of all of the Retirement System's assets. The benchmark for the domestic equity portion of the portfolio shall be the Standard & Poor's 1500.

The Retirement System employs Investment Advisory firms to assist in active management of the common stock portfolio. Monitoring of and communications with the Advisors shall be handled in accordance with the guidelines for Performance Objective Monitoring and Communication.

It is the policy of the Employees' Retirement System of Georgia that all new investments in the actively managed portion of domestic equities meet certain investment criteria. The purpose of the criteria is to manage capital risk and opportunity by seeking an assuredness of earnings growth and maintaining a high quality portfolio. The investment criteria can be classified as quantitative or qualitative. The quantitative criteria fall into three broad categories:

- Does a company have 8 years of financial history? Eight years of financial history is sufficient for a company to eliminate start-up problems and establish a credible presence in its particular business sector and in the financial markets.
- Does a company pass a growth, income, or cyclical test? Compartmentalizing companies by growth, income and cyclical and subjecting each category to a test has proven to be a valuable endeavor. The outcome of the effort (tests) has proven to be a highly useful aid in (1) selecting companies capable of enduring the ups and downs of business cycles and (2) investing in companies contributing above average returns to a portfolio.
- Does a company pass a specific bond or bond equivalent rating and/or a cash flow and/or a quality rating hurdle? Choosing companies that pass hurdles of quality, bond ratings, and/or cash flow criteria has proven to be an aid in selecting conservatively financed companies with high levels of self-financing capabilities.

The qualitative criteria include but are not limited to the following areas:

- The secular growth rate of the company
- The self-financing ability of the company
- The accounting history of the company
- The trend of profit margins and returns on equity of the company
- The degree to which the company has control over its destiny
- The dominant or unique position of the company within its industry
- The complexity and understandability of the corporate profile
- The quality of the company's management including integrity, innovative capacity, motivation, accessibility, and depth

If a company passes a combination of the above criteria/hurdles, the company is considered qualified for inclusion on Employees' "Master Approved List of Common Stocks". The Employees' Master Approved List will be a current list of companies maintained by the Division of Investment Services, which are considered to meet a level of risk and potential return suitable for the Employees' Retirement System of Georgia.

If an Investment Advisory firm requests approval to invest in a company on the Master Approved List, permission by the Investment Committee for buying the respective common stock could be arrived at both expeditiously and with a rather high level of conviction that the company, barring unforeseen economic conditions, will likely prove to be a prudent investment for the Employees' Retirement System of Georgia. If an Investment Advisory firm requests approval to invest in a company not on the Master Approved List, the company will be subject to additional scrutiny or examination by the Division of Investment Services.

It should be noted that small capitalization companies may not meet 8 years of financial history; growth, income or cyclical; etc. criteria. Small capitalization portfolios with large numbers of rather new, fast growing companies, always face some of these perceived deficiencies in comparison to larger capitalization portfolios. Moreover, the inclusion of a sufficient number of *qualified* small companies in a small capitalization portfolio that tracks closely a benchmark like the S&P 600 can be a complex task. Nevertheless, the favorable risk/return characteristics of small capitalization portfolios have proven over history to be a sound diversifying asset class for the total portfolio of retirement systems. In the case of small capitalization portfolios, the Division of Investment Services and the Investment Committee will take into consideration the rather unique attributes of these companies before determining their eligibility for addition to any advisor's small capitalization approved list or any future small capitalization master approved list.

Also included in the equity portion of the portfolio are international equities, as defined by Georgia Law (47-20-83). It is the policy of the Employees' Retirement System of Georgia that such international equities may comprise no more than 15% of the book value of total invested assets. These companies provide increased exposure to some of the more rapidly growing areas of the world as well as those with differing economic cycles.

Corresponding to the domestic equity portion of the fund, passive (index based) management of international equities is utilized as a low cost, low benchmark risk strategy for a core position of international equity assets. Active management of international equities may be utilized based on the belief – similar to domestic equities – that active management can enhance returns while maintaining a conservative investment policy. The benchmarks for the international equity portion of the portfolio shall be the MSCI EAFE and the MSCI ACWI ex. U.S. Free Index.

It is generally the policy of the Employees' Retirement System of Georgia that all new investments in the actively managed portion of international equities meet similar investment criteria as domestic equities (see above). For international companies, however, historical financial data is not as easy to obtain and may be sparse for some companies, especially those in the emerging markets. Therefore, for some international companies it may be necessary to reduce the financial history criteria of eight years, which is used for domestic equities, to a financial history criteria of five years. Identical to domestic equities, an international company that passes a combination of the investment criteria / hurdles is considered qualified for inclusion in the Employees' "Master Approved List of Common Stocks".

In the same manner as domestic equities, if an Investment Advisory firm requests approval to invest in an international company on the Master Approved List, permission by the Investment Committee for buying the respective common stock could be arrived at both expeditiously and with a rather high level of conviction that the company, barring unforeseen economic conditions, will likely prove to be a prudent investment for the Employees' Retirement System of Georgia. If an Investment Advisory firm requests approval to invest in an international company not on the Master Approved List, the company will be subject to additional scrutiny or examination by the Division of Investment Services.

Similar to the caveat relating to small capitalization companies, some securities of foreign companies, especially companies in emerging markets, could be deficient, to a degree, in meeting the aforementioned investment criteria. Nevertheless, the favorable risk/return characteristics of foreign company portfolios have proven over history to be a sound diversifying asset class for the total portfolio of retirement systems. As in the case of small capitalization portfolios, the Division of Investment Services and the Investment Committee will take into consideration the specific attributes of each foreign company before assessing its addition to any advisor's approved list.

Common stocks eligible for investment shall be approved by the Investment Committee. A list of approved stock investments shall be maintained by the Investment Division for each advisor's fund as established by the Committee. Said lists shall at all times meet the investment criteria heretofore referred to and at no time shall any one list exceed 60 names. No addition to an approved list shall be made without the approval of the Committee except by the procedure of adding a name from the Master Approved List as detailed below.

1. Prior to allowing the addition of a name to an advisor's list, approval of the Chairman or the Vice Chairman of the Investment Committee or the Chief Investment Officer or Co-Chief Investment Officer of the Division of Investment Services shall be obtained.
2. If the monthly trading volume in shares of the company under consideration did not exceed three million shares in the month previous, no more than one advisor may add the name in a month by this method. In addition, if a stock has an average monthly trading volume between one and three million shares over the last 12 months no other advisor may add the name. If a stock has over three million shares per month, additional advisors would be allowed to add the name.
3. Additions under this policy will be confirmed in person at a meeting of the Investment Committee.

Sales of equities are specifically authorized by the Investment Committee with the exception that up to 15% of the equity position of the Retirement System may be sold between monthly Investment Committee meetings without prior approval. However, sales in excess of 5% of the equity position of the Retirement System must be specifically approved by the Chief Investment Officer or Co-Chief Investment Officer, Division of Investment Services and sales in excess of 10% of the equity position of the Retirement System must be specifically approved by the Chairman or Vice Chairman of the Investment Committee prior to execution by the Investment Division. At the meeting immediately following such a sale, a full report will be made to the Committee as to 1) the price obtained; and 2) whether the funds were reinvested in common stocks or being held in a short-term investment.

Real Estate

Real Estate assets of the Employees' Retirement System of Georgia are limited and restricted by law solely to the Beta Building located at Two Northside 75, Atlanta, Georgia, and to real property acquired through judicial foreclosure of mortgage loans owned and held by the Retirement System at the time of foreclosure, or by any other judicial or court action that assigns ownership of real property to the Retirement System. It is the policy of the Retirement System to make every effort to sell or otherwise dispose of all such real property except that of the Beta Building within five years of date of acquisition.

Proxy Votes

It is the fiduciary responsibility of the Trustees of the Employees' Retirement System of Georgia to vote all proxies solely and exclusively in the best economic interests of the Retirement System. Accordingly, it is the policy of the Employees' Retirement System of Georgia to vote and execute all voting proxies in support of management except where, in the opinion of the Chief Investment Officer or Co-Chief Investment Officer of the Division of Investment Services such a vote would be detrimental to the best interests or rights of the Retirement System. A standing exception to this policy of voting with management is to always vote in favor of confidential proxy balloting as this has been determined to be in the best interests of the Retirement System.

Securities Fraud

The Board, in its fiduciary role, is cognizant of the possibility of securities fraud or illegal activity that may adversely impact the financial interests of the Retirement System. In the event evidence of such activity is detected, the Board should consider appropriate remedies. Accordingly, the Investment Division shall have standing instructions to take reasonable steps to identify and inform itself regarding allegations of securities fraud related to a company in which the Retirement System has a position. If the Investment Division finds that there are reasonable grounds to believe that the Retirement System has suffered a loss as a result of securities fraud, it shall evaluate the extent of the losses sustained by the Retirement System as a result thereof and promptly report its conclusions and recommendations to the Investment Committee of the Board. This will allow the Board to evaluate the potential claim and to determine an appropriate course of action, including the possibility of initiating or participating in litigation.

Personal Integrity

Participation in the affairs of any public body demands a high level of personal integrity and conduct. Especially is this true when wise utilization of the funds of others is involved. Members of the Board of Trustees and their investment staff must discharge their responsibilities without prejudice or favor, avoiding at all times pressures from social issues and any conduct which could create a conflict of interest.

April 17, 2008

GENERAL STATEMENT OF INVESTMENT POLICY

Employees' Retirement System of Georgia

INVESTMENT OBJECTIVE AND POLICY

The Employees' Retirement System of Georgia (the Retirement System) is governed by a Board of Trustees with broad statutory powers. The investment functions of the Retirement System are vested in this Board as set forth in Georgia laws and in its Investment Committee as set forth in the By-Laws of the said Board of Trustees.

RESPONSIBILITIES OF THE TRUSTEES

By accepting the appointment as trustee, each Trustee acknowledges that he/she is a Fiduciary with responsibilities as described herein.

A fiduciary to the plan must carry out his or her duties in accordance with the plan documents and laws governing the plan. A fiduciary can delegate investment management responsibilities to qualified professional investment personnel. The fiduciary should select all investment services prudently, based solely on the beneficial services to the ultimate beneficiaries of the plan. If a fiduciary or named fiduciary delegates his or her fiduciary responsibility, the fiduciary may still be liable for a breach of fiduciary duty if such delegation is shown to have been based upon influences other than the belief that the plan was best served by the delegation.

Fiduciaries must discharge their duties with respect to the plan:

- solely in the interest of plan participants and beneficiaries;
- for the exclusive purpose of providing benefits to participants and their beneficiaries;
- with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;
- by diversifying the investments of the plan so as to minimize the risk of large losses, unless doing so is clearly not prudent under the circumstances;
- in accordance with the governing plan documents and state laws;
- by being as prudent as the average expert, not simply the average person.

OBJECTIVE

The Board's investment objectives are to provide the greatest possible long-term benefits to members of the Retirement System by maximizing the total rate of return on investment within prudent limits of risk for a retirement fund of this type consistent with the investment return requirement assumed by the actuaries in determining the present and future soundness of the fund.

POLICY

First, Investment Policy is conservative in that it exhibits caution, diversifies risk, uses care in selecting securities and provides for protection against a possible substantial market decline. Secondly, Investment Policy must work toward a goal which maximizes total returns with an acceptable amount of risk to meet actuarial requirements.

Liquidity Needs

As the fund has matured, disbursements have come to exceed contributions. Investment income provides the primary source of liquidity but as the fund continues to mature liquidity needs must be consistently monitored.

Preservation of Capital

Payments from the pension fund, in many if not most instances, constitute the major source of income to retirees and the primary protection against the contingencies of death and disability of active workers. Consequently, the basic policy of the Board is preservation of the capital investment, together with realization of sufficient return to secure and facilitate payment of the statutory benefit requirements of the Retirement System to its beneficiaries.

The Board's policies provide for the utilization of all suitable and prudent avenues of investment authorized under the Georgia Statutes to maintain a high quality, diversified portfolio of investments in conservatively financed companies, the prospects of which are continually reviewed and assessed in the varying economic climate. Consistent performance of the total portfolio is emphasized. Income is expected to be a key part of investment return, not only for the portfolio as a whole but for the equity sector as well. Growth of income is a key objective, particularly in the equity sector.

Diversification

Diversification of the portfolio with respect to types of assets, types of industries, companies within industries, quality of the investment, maturities, geographic areas, etc., is an important limitation of risk. All such diversification is considered within the context of the requirements of the Georgia Statutes and the economic climate at various times to assure the maintenance of a diversified portfolio responsive to changing economic conditions. Diversification by asset types requires investments in the fixed-income area, mainly bonds and mortgages of various types, and equity investments.

Asset Allocation

The investment assets of the Employees' Retirement System of Georgia are, by statute, prohibited from being allocated more than 60% to equity securities. The Division of Investment Services' policy for implementing this statute is to not allocate any new money to equities which would result in the total cost of equities exceeding 60% of the total cost of all investments. Also by law, the Retirement System can invest no more than 15% of the assets in obligations of foreign corporations as defined in the statute, again based on the cost of investments and the same policy for implementation as for equity percentages. The cost of investments is computed using the original cost of equity securities and the amortized cost of bonds, which means that gains and losses on bond swaps and premiums and discounts are recognized ratably over the life of the bonds purchased.

Rebalancing Asset Classes and Equity Portfolios

Since it is recognized that the fund is long term oriented, investment decisions should be made in order to maximize long term performance and should not be focused on short term movements in the financial markets.

The Investment Committee reviews the asset allocation decision and the equity portfolio mix on a yearly basis. There may, however, be infrequent times due to market or other conditions when such rebalancing may need to be considered more often.

In looking at the rebalancing, the Committee should focus on the asset allocation between bonds and equity and consider their longer term potential and the legal limits, as well as the needs of the Retirement System.

When looking at individual equity portfolios the Committee should:

- 1) Focus on containing the number of portfolios, as too many portfolios result in a replication of index performance at a high cost. Each portfolio is intended to add value around a risk controlled core.
- 2) Take into account the overall balance of the equity portfolios into sub classes i.e., value, growth, active, passive, and market capitalizations.
- 3) Look at each portfolio versus the equity benchmark as well as versus the applicable benchmark for the specific portfolio in terms of both return and risk. Additional evaluation criteria in the "Statement of Policy on Investment Advisory Services" should also be used.
- 4) Consider additional advisors to address a need in the portfolio while keeping total number of advisors within desired limits. If the decision to add an advisor is reached, the guidelines in the "Statement of Policy on Investment Advisor Services" should be followed.
- 5) Consider the return versus the cost of various investments in order to make the most efficient allocation.
- 6) Make the asset changes to best serve the Retirement System in the upcoming year after consideration of all relevant factors.

Short-Term Investments

It is the policy of the Retirement System to use short-term investments to provide adequate protection against downward market movements and to assist the overall return objectives. Because of the size of both the bond and equity sectors of the portfolio, and because of the essentially long-term nature of the fund, it is not anticipated that major moves will be made into or out of such cash reserves. Under normal circumstances, a reserve of 10% of the combined value of the bond and equity portfolios shall be considered the maximum limit.

Short-term investments may be made in commercial paper, master notes, U. S. Treasury obligations or repurchase agreements with the responsibility resting with the investment staff as to selection of the specific instrument to be used. Commercial paper purchases by the Retirement System shall have a maturity of not more than 180 days and shall be rated P-1 by Moody's Investment Services, Inc. and/or A-1 by Standard & Poor's Corporation. Master notes must be administered by the Custodian Bank and must be an obligation of a corporation whose commercial paper is rated P-1 by Moody's or A-1 by Standard and Poor's. Investments in commercial paper or master notes shall be limited to no more than \$100 million in any one name. Repurchase agreements shall be limited to the purchase of U. S. Treasury or Agency obligations or corporate bonds rated at least "A" by one and no lower than "A" by any major rating agency with a market value in excess of funds advanced.

Fixed-Income Investments

The fixed-income investments include both bonds and mortgages of various types carefully selected on the basis of return, quality, marketability, and overall suitability to the Retirement System's portfolio.

Bonds

It is the policy of the Retirement System that bonds shall represent an important part of the total assets of the Retirement System. The amount of this representation shall vary depending upon economic conditions, interest rates, and relative attractiveness of other available avenues of investment. The Board's policy requires that the bond portfolio be of high quality and chosen with respect to maturity ranges, coupon levels, refunding characteristics, and marketability. Active management of the bond portfolio is encouraged to continually improve the Retirement System's portfolio in terms of quality, marketability, income refunding protection, etc. Market timing, however, should not be implied by a policy of active management. The absolute size of total assets makes market timing impractical.

Investment policy must also be guided by the need to finance long-term liabilities with income return from long-term assets having a high degree of predictability. Quality bonds satisfy this need in that returns from high grade investments in fixed-income securities are highly predictable. In order to meet the quality standards it shall be the policy of the Retirement System to require that new purchases of corporate bonds be restricted to high grade bonds rated at least "A" by one and no lower than "A" by any major rating agency. If a bond in the Retirement System's portfolio is subsequently downgraded to a rating below "A" it shall be placed on a watch list and must be considered as a candidate for sale.

All bond purchases shall have a maturity greater than one year. Purchases of new issues of long-term bonds having a maturity in excess of 15 years are restricted to obligations which have at least 10 years non-refunding protection. Corporate bond investments in any one name shall also be limited to no more than 5% of total assets of the Retirement System.

Sales of bonds are specifically authorized by the Investment Committee with the exception that up to 10% of the bond position of the Retirement System may be sold between monthly Investment Committee meetings without prior approval, provided such sales in excess of 5% of the bond position of the Retirement System must be specifically approved by the Chairman of the Investment Committee prior to execution by the Investment Division. Proceeds from any such sale will be added to the outstanding bond purchase authorization. At the meeting immediately following such a sale, a full report will be made to the Committee as to the price obtained.

Canadian Provincial Obligations

Canadian obligations are legal investments under the law. However, it has been and is currently the policy of the Retirement System to restrict purchases to new issues payable in U. S. dollars that are issued by the Provinces of Ontario, Quebec and British Columbia. Quality and call protection requirements are the same as set forth above under corporate new issue bonds. Total holdings of said Canadian obligations are limited to no more than 10% of the portfolio, 5% in any one name.

Bond Exchange Program

It is the policy of the Retirement System to encourage a bond exchange program so as to improve the final return to the Retirement System. Such a bond exchange program shall, however, be restricted to bond exchanges and bond swap transactions which will improve yield, call protection, quality or maturity distribution. Any other types of exchanges must receive prior approval of the Investment Committee. The Division of Investment Services is authorized to make such transactions, provided justification for each swap is in writing and on file with the Division of Investment Services. The following guidelines shall control all bond exchange (bond swap) transactions:

- (1) A bond swap shall be defined as a transaction involving a simultaneous purchase and sale of a corporate or Government obligation.
- (2) There shall be no swap in a security which will result in a reduction in quality below that of an "A" rating by a nationally recognized rating agency.
- (3) Amortization of gains and losses shall be by the straight-line method over the life of the purchased bond.

Private Placements of Georgia Corporations

It is the policy of the Retirement System to invest in obligations of Georgia corporations or in obligations of corporations where the proceeds from such loans are to be spent wholly in the State of Georgia. Said investments must have an investment quality equal to or better than an "A" rated bond. No such investment shall exceed 5% of total assets nor shall the total of said assets exceed 10% of total investment assets of the Retirement System. If not fully guaranteed by the United States Government each such private placement must be specifically approved by the Investment Committee.

Private Placements of U. S. Government Guaranteed Real Estate Securities

The Board is aware of the desirability of contributing to the economic well-being of the State of Georgia by encouraging home ownership and the construction of such facilities as apartments, nursing homes, and housing for the elderly. It is the policy of the Retirement System to invest in obligations secured by a first mortgage on such facilities provided such obligations are fully guaranteed by the United States Government or are included in a "Pass-Through" security which is fully guaranteed by the United States Government. Yields on such securities should equal or exceed yields currently available on recently offered corporate bonds rated Aaa. Private Placements of such U. S. Government guaranteed real estate securities shall be purchased and managed under the "Bonds" section of this policy.

Mortgages

Mortgage investments shall include those not guaranteed by the U. S. Government and pass-through securities issued against specific pools of mortgages. The amount of such investments shall depend upon economic conditions, interest rates, and relative attractiveness of other available avenues of investments and shall be limited in amount to no more than 10% of total assets, 1% in any one loan. It shall further be the policy of the Retirement System to limit such investments to mortgage loans or securities secured by first mortgages on improved real property located in the State of Georgia having a loan-to-value ratio no higher than 75%. All mortgage investment shall be of high quality and must be specifically approved by the Investment Committee.

Equity Investments

Since fixed-income investments provide only for a current income stream and make no provisions for a hedge against inflation, the policy of the Employees' Retirement System of Georgia provides that such a long-term inflation hedge be obtained by the use of equity investments. This policy provides for flexibility in a changing economic environment and allows for maximization of total return through the judicious use of a combination of both fixed-income and equity investments.

It is the policy of the Employees' Retirement System of Georgia to limit such investments in equities to no more than 60% of the book value of the total invested assets. It shall further be the policy of the Retirement System to limit an investment in the equity of any one corporation to no more than 5% of the book value of the equity portfolio and that such investment shall not exceed 5% of the outstanding equity of the issuing corporation.

In the domestic equity portion of the fund, the Employees' Retirement System of Georgia utilizes different styles of management. Passive (index based) management is utilized as a low cost, low benchmark risk strategy for a core portion of the equity assets. Active management of the common stock portfolio is based on the belief that active management can enhance returns to the fund while maintaining the same conservative investment policy which is the guiding principle behind the investment of all of the Retirement System's assets. The benchmark for the domestic equity portion of the portfolio shall be the Standard & Poor's 900.

The Retirement System employs Investment Advisory firms to assist in active management of the common stock portfolio. Monitoring of and communications with the Advisors shall be handled in accordance with the guidelines for Performance Objective Monitoring and Communication.

It is the policy of the Employees' Retirement System of Georgia that all new investments in the actively managed portion of domestic equities meet certain investment criteria. The purpose of the criteria is to manage capital risk and opportunity by seeking an assuredness of earnings growth and maintaining a high quality portfolio. The investment criteria can be classified as quantitative or qualitative. The quantitative criteria fall into three broad categories:

- Does a company have 8 years of financial history? Eight years of financial history is sufficient for a company to eliminate start-up problems and establish a credible presence in its particular business sector and in the financial markets.
- Does a company pass a growth, income, or cyclical test? Compartmentalizing companies by growth, income and cyclical and subjecting each category to a test has proven to be a valuable endeavor. The outcome of the effort (tests) has proven to be a highly useful aid in (1) selecting companies capable of enduring the ups and downs of business cycles and (2) investing in companies contributing above average returns to a portfolio.
- Does a company pass a specific bond or bond equivalent rating and/or a cash flow and/or a quality rating hurdle? Choosing companies that pass hurdles of quality, bond ratings, and/or cash flow criteria has proven to be an aid in selecting conservatively financed companies with high levels of self-financing capabilities.

The qualitative criteria include but are not limited to the following areas:

- The secular growth rate of the company
- The self-financing ability of the company
- The accounting history of the company
- The trend of profit margins and returns on equity of the company
- The degree to which the company has control over its destiny
- The dominant or unique position of the company within its industry
- The complexity and understandability of the corporate profile
- The quality of the company's management including integrity, innovative capacity, motivation, accessibility, and depth

If a company passes a combination of the above criteria/hurdles, the company is considered qualified for inclusion on Employees' "Master Approved List of Common Stocks". The Employees' Master Approved List will be a current list of companies maintained by the Division of Investment Services, which are considered to meet a level of risk and potential return suitable for the Employees' Retirement System of Georgia.

If an Investment Advisory firm requests approval to invest in a company on the Master Approved List, permission by the Investment Committee for buying the respective common stock could be arrived at both expeditiously and with a rather high level of conviction that the company, barring unforeseen economic conditions, will likely prove to be a prudent investment for the Employees' Retirement System of Georgia. If an Investment Advisory firm requests approval to invest in a company not on the Master Approved List, the company will be subject to additional scrutiny or examination by the Division of Investment Services.

It should be noted that small capitalization companies may not meet 8 years of financial history; growth, income or cyclical; etc. criteria. Small capitalization portfolios with large numbers of rather new, fast growing companies, always face some of these perceived deficiencies in comparison to larger capitalization portfolios. Moreover, the inclusion of a sufficient number of *qualified* small companies in a small capitalization portfolio that tracks closely a benchmark like the S&P 600 can be a complex task. Nevertheless, the favorable risk/return characteristics of small capitalization portfolios have proven over history to be a sound diversifying asset class for the total portfolio of retirement systems. In the case of small capitalization portfolios, the Division of Investment Services and the Investment Committee will take into consideration the rather unique attributes of these companies before determining their eligibility for addition to any advisor's small capitalization approved list or any future small capitalization master approved list.

Also included in the equity portion of the portfolio are international equities, defined as those of companies headquartered outside the United States or Canada. It is the policy of the Employees' Retirement System of Georgia that such international equities may comprise no more than 15% of the book value of total invested assets. These companies provide increased exposure to some of the more rapidly growing areas of the world as well as those with differing economic cycles. Only U.S. traded securities of these foreign companies will be used in the portfolio as this has been shown to provide sufficient diversification.

Corresponding to the domestic equity portion of the fund, passive (index based) management of international equities is utilized as a low cost, low benchmark risk strategy for a core position of international equity assets. Active management of international equities may be utilized based on the belief – similar to domestic equities – that active management can enhance returns while maintaining a conservative investment policy. The benchmark for the international equity portion of the portfolio shall be the MSCI EAFE/ (MSCI ACWI ex. U.S. Free Index).

It is generally the policy of the Employees' Retirement System of Georgia that all new investments in the actively managed portion of international equities meet similar investment criteria as domestic equities (see above). For international companies, however, historical financial data is not as easy to obtain and may be sparse for some companies, especially those in the emerging markets. Therefore, for some international companies it may be necessary to reduce the financial history criteria of eight years, which is used for domestic equities, to a financial history criteria of five years. Identical to domestic equities, an international company that passes a combination of the investment criteria / hurdles is considered qualified for inclusion in the Employees' "Master Approved List of Common Stocks".

In the same manner as domestic equities, if an Investment Advisory firm requests approval to invest in an international company on the Master Approved List, permission by the Investment Committee for buying the respective common stock could be arrived at both expeditiously and with a rather high level of conviction that the company, barring unforeseen economic conditions, will likely prove to be a prudent investment for the Employees' Retirement System of Georgia. If an Investment Advisory firm requests approval to invest in an international company not on the Master Approved List, the company will be subject to additional scrutiny or examination by the Division of Investment Services.

Similar to the caveat relating to small capitalization companies, some U.S. traded securities of foreign companies, especially companies in emerging markets, could be deficient, to a degree, in meeting the aforementioned investment criteria. Nevertheless, the favorable risk/return characteristics of foreign company portfolios have proven over history to be a sound diversifying asset class for the total portfolio of retirement systems. As in the case of small capitalization portfolios, the Division of Investment Services and the Investment Committee will take into consideration the specific attributes of each foreign company before assessing its addition to any advisor's approved list.

Common stocks eligible for investment shall be approved by the Investment Committee prior to purchase. A list of approved stock investments shall be maintained by the Investment Division for each advisor's fund as established by the Committee. Said lists shall at all times meet the investment criteria heretofore referred to and at no time shall any one list exceed 60 names. No addition to an approved list shall be made without the approval of the Committee except by the procedure of adding a name from the Master Approved List as detailed below.

1. Prior to allowing the addition of a name to an advisor's list, approval of the Chairman or the Vice Chairman of the Investment Committee or the Chief Investment Officer or Co-Chief Investment Officer of the Division of Investment Services shall be obtained.
2. If the monthly trading volume in shares of the company under consideration did not exceed three million shares in the month previous, no more than one advisor may add the name in a month by this method. In addition, if a stock has an average monthly trading volume between one and three million shares over the last 12 months no other advisor may add the name. If a stock has over three million shares per month, additional advisors would be allowed to add the name.
3. Additions under this policy will be confirmed in person at a meeting of the Investment Committee.

Sales of equities are specifically authorized by the Investment Committee with the exception that up to 15% of the equity position of the Retirement System may be sold between monthly Investment Committee meetings without prior approval. However, sales in excess of 5% of the equity position of the Retirement System must be specifically approved by the Chief Investment Officer or Co-Chief Investment Officer, Division of Investment Services and sales in excess of 10% of the equity position of the Retirement System must be specifically approved by the Chairman or Vice Chairman of the Investment Committee prior to execution by the Investment Division. At the meeting immediately following such a sale, a full report will be made to the Committee as to 1) the price obtained; and 2) whether the funds were reinvested in common stocks or being held in a short-term investment.

Real Estate

Real Estate assets of the Employees' Retirement System of Georgia are limited and restricted by law solely to the Beta Building located at Two Northside 75, Atlanta, Georgia, and to real property acquired through judicial foreclosure of mortgage loans owned and held by the Retirement System at the time of foreclosure, or by any other judicial or court action that assigns ownership of real property to the Retirement System. It is the policy of the Retirement System to make every effort to sell or otherwise dispose of all such real property except that of the Beta Building within five years of date of acquisition.

Proxy Votes

It is the fiduciary responsibility of the Trustees of the Employees' Retirement System of Georgia to vote all proxies solely and exclusively in the best economic interests of the Retirement System. Accordingly, it is the policy of the Employees' Retirement System of Georgia to vote and execute all voting proxies in support of management except where, in the opinion of the Chief Investment Officer of the Division of Investment Services such a vote would be detrimental to the best interests or rights of the Retirement System. A standing exception to this policy of voting with management is to always vote in favor of confidential proxy balloting as this has been determined to be in the best interests of the Retirement System.

Securities Fraud

The Board, in its fiduciary role, is cognizant of the possibility of securities fraud or illegal activity that may adversely impact the financial interests of the Retirement System. In the event evidence of such activity is detected, the Board should consider appropriate remedies. Accordingly, the Investment Division shall have standing instructions to take reasonable steps to identify and inform itself regarding allegations of securities fraud related to a company in which the Retirement System has a position. If the Investment Division finds that there are reasonable grounds to believe that the Retirement System has suffered a loss as a result of securities fraud, it shall evaluate the extent of the losses sustained by the Retirement System as a result thereof and promptly report its conclusions and recommendations to the Investment Committee of the Board. This will allow the Board to evaluate the potential claim and to determine an appropriate course of action, including the possibility of initiating or participating in litigation.

Personal Integrity

Participation in the affairs of any public body demands a high level of personal integrity and conduct. Especially is this true when wise utilization of the funds of others is involved. Members of the Board of Trustees and their investment staff must discharge their responsibilities without prejudice or favor, avoiding at all times pressures from social issues and any conduct which could create a conflict of interest.

May 17, 2007

GENERAL STATEMENT OF INVESTMENT POLICY

Employees' Retirement System of Georgia

INVESTMENT OBJECTIVE AND POLICY

The Employees' Retirement System of Georgia (the Retirement System) is governed by a Board of Trustees with broad statutory powers. The investment functions of the Retirement System are vested in this Board as set forth in Georgia laws and in its Investment Committee as set forth in the By-Laws of the said Board of Trustees.

RESPONSIBILITIES OF THE TRUSTEES

By accepting the appointment as trustee, each Trustee acknowledges that he/she is a Fiduciary with responsibilities as described herein.

A fiduciary to the plan must carry out his or her duties in accordance with the plan documents and laws governing the plan. A fiduciary can delegate investment management responsibilities to qualified professional investment personnel. The fiduciary should select all investment services prudently, based solely on the beneficial services to the ultimate beneficiaries of the plan. If a fiduciary or named fiduciary delegates his or her fiduciary responsibility, the fiduciary may still be liable for a breach of fiduciary duty if such delegation is shown to have been based upon influences other than the belief that the plan was best served by the delegation.

Fiduciaries must discharge their duties with respect to the plan:

- solely in the interest of plan participants and beneficiaries;
- for the exclusive purpose of providing benefits to participants and their beneficiaries;
- with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;
- by diversifying the investments of the plan so as to minimize the risk of large losses, unless doing so is clearly not prudent under the circumstances;
- in accordance with the governing plan documents and state laws;
- by being as prudent as the average expert, not simply the average person.

OBJECTIVE

The Board's investment objectives are to provide the greatest possible long-term benefits to members of the Retirement System by maximizing the total rate of return on investment within prudent limits of risk for a retirement fund of this type consistent with the investment return requirement assumed by the actuaries in determining the present and future soundness of the fund.

POLICY

First, Investment Policy is conservative in that it exhibits caution, diversifies risk, uses care in selecting securities and provides for protection against a possible substantial market decline. Secondly, Investment Policy must work toward a goal which maximizes total returns with an acceptable amount of risk to meet actuarial requirements.

Liquidity Needs

As the fund has matured, disbursements have come to exceed contributions. Investment income provides the primary source of liquidity but as the fund continues to mature liquidity needs must be consistently monitored.

Preservation of Capital

Payments from the pension fund, in many if not most instances, constitute the major source of income to retirees and the primary protection against the contingencies of death and disability of active workers. Consequently, the basic policy of the Board is preservation of the capital investment, together with realization of sufficient return to secure and facilitate payment of the statutory benefit requirements of the Retirement System to its beneficiaries.

The Board's policies provide for the utilization of all suitable and prudent avenues of investment authorized under the Georgia Statutes to maintain a high quality, diversified portfolio of investments in conservatively financed companies, the prospects of which are continually reviewed and assessed in the varying economic climate. Consistent performance of the total portfolio is emphasized. Income is expected to be a key part of investment return, not only for the portfolio as a whole but for the equity sector as well. Growth of income is a key objective, particularly in the equity sector.

Diversification

Diversification of the portfolio with respect to types of assets, types of industries, companies within industries, quality of the investment, maturities, geographic areas, etc., is an important limitation of risk. All such diversification is considered within the context of the requirements of the Georgia Statutes and the economic climate at various times to assure the maintenance of a diversified portfolio responsive to changing economic conditions. Diversification by asset types requires investments in the fixed-income area, mainly bonds and mortgages of various types, and equity investments.

Asset Allocation

The investment assets of the Employees' Retirement System of Georgia are, by statute, prohibited from being allocated more than 60% to equity securities. The Division of Investment Services' policy for implementing this statute is to not allocate any new money to equities which would result in the total cost of equities exceeding 60% of the total cost of all investments. Also by statute, the Retirement System can invest no more than 10% of the assets in obligations of corporations domiciled outside the United States or Canada, again based on the cost of investments and the same policy for implementation as for equity percentages. The cost of investments is computed using the original cost of equity securities and the amortized cost of bonds, which means that gains and losses on bond swaps and premiums and discounts are recognized ratably over the life of the bonds purchased.

Rebalancing Asset Classes and Equity Portfolios

Since it is recognized that the fund is long term oriented, investment decisions should be made in order to maximize long term performance and should not be focused on short term movements in the financial markets.

The Investment Committee reviews the asset allocation decision and the equity portfolio mix on a yearly basis. There may, however, be infrequent times due to market or other conditions when such rebalancing may need to be considered more often.

In looking at the rebalancing, the Committee should focus on the asset allocation between bonds and equity and consider their longer term potential and the legal limits, as well as the needs of the Retirement System.

When looking at individual equity portfolios the Committee should:

- 1) Focus on containing the number of portfolios, as too many portfolios result in a replication of index performance at a high cost. Each portfolio is intended to add value around a risk controlled core.
- 2) Take into account the overall balance of the equity portfolios into sub classes i.e., value, growth, active, passive, and market capitalizations.
- 3) Look at each portfolio versus the equity benchmark as well as versus the applicable benchmark for the specific portfolio in terms of both return and risk. Additional evaluation criteria in the "Statement of Policy on Investment Advisory Services" should also be used.
- 4) Consider additional advisors to address a need in the portfolio while keeping total number of advisors within desired limits. If the decision to add an advisor is reached, the guidelines in the "Statement of Policy on Investment Advisor Services" should be followed.
- 5) Consider the return versus the cost of various investments in order to make the most efficient allocation.
- 6) Make the asset changes to best serve the Retirement System in the upcoming year after consideration of all relevant factors.

Short-Term Investments

It is the policy of the Retirement System to use short-term investments to provide adequate protection against downward market movements and to assist the overall return objectives. Because of the size of both the bond and equity sectors of the portfolio, and because of the essentially long-term nature of the fund, it is not anticipated that major moves will be made into or out of such cash reserves. Under normal circumstances, a reserve of 10% of the combined value of the bond and equity portfolios shall be considered the maximum limit.

Short-term investments may be made in commercial paper, master notes, U. S. Treasury obligations or repurchase agreements with the responsibility resting with the investment staff as to selection of the specific instrument to be used. Commercial paper purchases by the Retirement System shall have a maturity of not more than 180 days and shall be rated P-1 by Moody's Investment Services, Inc. and/or A-1 by Standard & Poor's Corporation. Master notes must be administered by the Custodian Bank and must be an obligation of a corporation whose commercial paper is rated P-1 by Moody's or A-1 by Standard and Poor's. Investments in commercial paper or master notes shall be limited to no more than \$100 million in any one name. Repurchase agreements shall be limited to the purchase of U. S. Treasury or Agency obligations or corporate bonds rated at least "A" by one and no lower than "A" by any major rating agency with a market value in excess of funds advanced.

Fixed-Income Investments

The fixed-income investments include both bonds and mortgages of various types carefully selected on the basis of return, quality, marketability, and overall suitability to the Retirement System's portfolio.

Bonds

It is the policy of the Retirement System that bonds shall represent an important part of the total assets of the Retirement System. The amount of this representation shall vary depending upon economic conditions, interest rates, and relative attractiveness of other available avenues of investment. The Board's policy requires that the bond portfolio be of high quality and chosen with respect to maturity ranges, coupon levels, refunding characteristics, and marketability. Active management of the bond portfolio is encouraged to continually improve the Retirement System's portfolio in terms of quality, marketability, income refunding protection, etc. Market timing, however, should not be implied by a policy of active management. The absolute size of total assets makes market timing impractical.

Investment policy must also be guided by the need to finance long-term liabilities with income return from long-term assets having a high degree of predictability. Quality bonds satisfy this need in that returns from high grade investments in fixed-income securities are highly predictable. In order to meet the quality standards it shall be the policy of the Retirement System to require that new purchases of corporate bonds be restricted to high grade bonds rated at least "A" by one and no lower than "A" by any major rating agency. If a bond in the Retirement System's portfolio is subsequently downgraded to a rating below "A" it shall be placed on a watch list and must be considered as a candidate for sale.

All bond purchases shall have a maturity greater than one year. Purchases of new issues of long-term bonds having a maturity in excess of 15 years are restricted to obligations which have at least 10 years non-refunding protection. Corporate bond investments in any one name shall also be limited to no more than 5% of total assets of the Retirement System.

Sales of bonds are specifically authorized by the Investment Committee with the exception that up to 10% of the bond position of the Retirement System may be sold between monthly Investment Committee meetings without prior approval, provided such sales in excess of 5% of the bond position of the Retirement System must be specifically approved by the Chairman of the Investment Committee prior to execution by the Investment Division. Proceeds from any such sale will be added to the outstanding bond purchase authorization. At the meeting immediately following such a sale, a full report will be made to the Committee as to the price obtained.

Canadian Provincial Obligations

Canadian obligations are legal investments under the law. However, it has been and is currently the policy of the Retirement System to restrict purchases to new issues payable in U. S. dollars that are issued by the Provinces of Ontario, Quebec and British Columbia. Quality and call protection requirements are the same as set forth above under corporate new issue bonds. Total holdings of said Canadian obligations are limited to no more than 10% of the portfolio, 5% in any one name.

Bond Exchange Program

It is the policy of the Retirement System to encourage a bond exchange program so as to improve the final return to the Retirement System. Such a bond exchange program shall, however, be restricted to bond exchanges and bond swap transactions which will improve yield, call protection, quality or maturity distribution. Any other types of exchanges must receive prior approval of the Investment Committee. The Division of Investment Services is authorized to make such transactions, provided justification for each swap is in writing and on file with the Division of Investment Services. The following guidelines shall control all bond exchange (bond swap) transactions:

1. A bond swap shall be defined as a transaction involving a simultaneous purchase and sale of a corporate or Government obligation.
2. There shall be no swap in a security which will result in a reduction in quality below that of an "A" rating by a nationally recognized rating agency.
3. Amortization of gains and losses shall be by the straight-line method over the life of the purchased bond.

Private Placements of Georgia Corporations

It is the policy of the Retirement System to invest in obligations of Georgia corporations or in obligations of corporations where the proceeds from such loans are to be spent wholly in the State of Georgia. Said investments must have an investment quality equal to or better than an "A" rated bond. No such investment shall exceed 5% of total assets nor shall the total of said assets exceed 10% of total investment assets of the Retirement System. If not fully guaranteed by the United States Government each such private placement must be specifically approved by the Investment Committee.

Private Placements of U. S. Government Guaranteed Real Estate Securities

The Board is aware of the desirability of contributing to the economic well-being of the State of Georgia by encouraging home ownership and the construction of such facilities as apartments, nursing homes, and housing for the elderly. It is the policy of the Retirement System to invest in obligations secured by a first mortgage on such facilities provided such obligations are fully guaranteed by the United States Government or are included in a "Pass-Through" security which is fully guaranteed by the United States Government. Yields on such securities should equal or exceed yields currently available on recently offered corporate bonds rated "Aaa." Private Placements of such U. S. Government guaranteed real estate securities shall be purchased and managed under the "Bonds" section of this policy.

Mortgages

Mortgage investments shall include those not guaranteed by the U. S. Government and pass-through securities issued against specific pools of mortgages. The amount of such investments shall depend upon economic conditions, interest rates, and relative attractiveness of other available avenues of investments and shall be limited in amount to no more than 10% of total assets, 1% in any one loan. It shall further be the policy of the Retirement System to limit such investments to mortgage loans or securities secured by first mortgages on improved real property located in the State of Georgia having a loan-to-value ratio no higher than 75%. All mortgage investments shall be of high quality and must be specifically approved by the Investment Committee.

Equity Investments

Since fixed-income investments provide only for a current income stream and make no provisions for a hedge against inflation, the policy of the Employees' Retirement System of Georgia provides that such a long-term inflation hedge be obtained by the use of equity investments. This policy provides for flexibility in a changing economic environment and allows for maximization of total return through the judicious use of a combination of both fixed-income and equity investments.

It is the policy of the Employees' Retirement System of Georgia to limit such investments in equities to no more than 60% of the book value of the total invested assets. It shall further be the policy of the Retirement System to limit an investment in the equity of any one corporation to no more than 5% of the book value of the equity portfolio and that such investment shall not exceed 5% of the outstanding equity of the issuing corporation.

In the domestic equity portion of the fund, the Employees' Retirement System of Georgia utilizes different styles of management. Passive (index based) management is utilized as a low cost, low benchmark risk strategy for a core portion of the equity assets. Active management of the common stock portfolio is based on the belief that active management can enhance returns to the fund while maintaining the same conservative investment policy which is the guiding principle behind the investment of all of the Retirement System's assets. The benchmark for the domestic equity portion of the portfolio shall be the Standard & Poor's 900.

The Retirement System employs Investment Advisory firms to assist in active management of the common stock portfolio. Monitoring of and communications with the Advisors shall be handled in accordance with the guidelines for Performance Objective Monitoring and Communication.

It is the policy of the Employees' Retirement System of Georgia that all new investments in the actively managed portion of equities meet certain investment criteria. The purpose of the criteria is to manage capital risk and opportunity by seeking an assuredness of earnings growth and maintaining a high quality portfolio. The investment criteria can be classified as quantitative or qualitative. The quantitative criteria fall into three broad categories:

- Does a company have 8 years of financial history? Eight years of financial history is sufficient for a company to eliminate start-up problems and establish a credible presence in its particular business sector and in the financial markets.
- Does a company pass a growth, income, or cyclical test? Compartmentalizing companies by growth, income and cyclical and subjecting each category to a test has proven to be a valuable endeavor. The outcome of the effort (tests) has proven to be a highly useful aid in (1) selecting companies capable of enduring the ups and downs of business cycles and (2) investing in companies contributing above average returns to a portfolio.
- Does a company pass a specific bond or bond equivalent rating and/or a cash flow and/or a quality rating hurdle? Choosing companies that pass hurdles of quality, bond ratings, and/or cash flow criteria has proven to be an aid in selecting conservatively financed companies with high levels of self-financing capabilities.

The qualitative criteria include but are not limited to the following areas:

- The secular growth rate of the company
- The self-financing ability of the company
- The accounting history of the company
- The trend of profit margins and returns on equity of the company
- The degree to which the company has control over its destiny
- The dominant or unique position of the company within its industry
- The complexity and understandability of the corporate profile
- The quality of the company's management including integrity, innovative capacity, motivation, accessibility, and depth

If a company passes a combination of the above criteria/hurdles, the company is considered qualified for inclusion on Employees' "Master Approved List of Common Stocks". The Employees' Master Approved List will be a current list of companies maintained by the Division of Investment Services, which are considered to meet a level of risk and potential return suitable for the Employees' Retirement System of Georgia.

If an Investment Advisory firm requests approval to invest in a company on the Master Approved List, permission by the Investment Committee for buying the respective common stock could be arrived at both expeditiously and with a rather high level of conviction that the company, barring unforeseen economic conditions, will likely prove to be a prudent investment for the Employees' Retirement System of Georgia. If an Investment Advisory firm requests approval to invest in a company not on the Master Approved List, the company will be subject to additional scrutiny or examination by the Division of Investment Services.

It should be noted that small capitalization companies may not meet 8 years of financial history; growth, income or cyclical; etc. criteria. Small capitalization portfolios with large numbers of rather new, fast growing companies, always face some of these perceived deficiencies in comparison to larger capitalization portfolios. Moreover, the inclusion of a sufficient number of *qualified* small companies in a small capitalization portfolio that tracks closely a benchmark like the S&P 600 can be a complex task. Nevertheless, the favorable risk/return characteristics of small capitalization portfolios have proven over history to be a sound diversifying asset class for the total portfolio of retirement systems. In the case of small capitalization portfolios, the Division of Investment Services and the Investment Committee will take into consideration the rather unique attributes of these companies before determining their eligibility for addition to any advisor's small capitalization approved list or any future small capitalization master approved list.

Also included in the equity portion of the portfolio are international equities, defined as those of companies headquartered outside the United States or Canada. It is the policy of the Employees' Retirement System of Georgia that such international equities may comprise no more than 10% of the book value of total invested assets. These companies provide increased exposure to some of the more rapidly growing areas of the world as well as those with differing economic cycles. Only U.S. traded securities of these foreign companies will be used in the portfolio as this has been shown to provide sufficient diversification.

Corresponding to the domestic equity portion of the fund, passive (index based) management of international equities is utilized as a low cost, low benchmark risk for a core position of international equity assets. Active management of international equities may be utilized based on the belief – similar to domestic equities – that active management can enhance returns while maintaining a conservative investment policy. The benchmark for the international equity portion of the portfolio shall be the MSCI EAFE/ (MSCI ACWI ex. U.S. Free Index).

It is generally the policy of the Employees' Retirement System of Georgia that all new investments in the actively managed portion of international equities meet similar investment criteria as domestic equities (see above). For international companies, however, historical financial data is not as easy to obtain and may be sparse for some companies, especially those in the emerging markets. Therefore, for some international companies it may be necessary to reduce the financial history criteria of eight years, which is used for domestic equities, to a financial history criteria of five. Identical to domestic equities, an international company that passes a combination of the investment criteria / hurdles is considered qualified for inclusion in the Employees' "Master Approved List of Common Stocks".

In the same manner as domestic equities, if an Investment Advisory firm requests approval to invest in an international company on the Master Approved List, permission by the Investment Committee for buying the respective common stock could be arrived at both expeditiously and with a rather high level of conviction that the company, barring unforeseen economic conditions, will likely prove to be a prudent investment for the Employees' Retirement System of Georgia. If an Investment Advisory firm requests approval to invest in an international company not on the Master Approved List, the company will be subject to additional scrutiny or examination by the Division of Investment Services.

Similar to the caveat relating to small capitalization companies, some U.S. traded securities of foreign companies, especially companies in emerging markets, could be deficient, to a degree, in meeting the aforementioned investment criteria. Nevertheless, the favorable risk/return characteristics of foreign company portfolios have proven over history to be a sound diversifying asset class for the total portfolio of retirement systems. As in the case of small capitalization portfolios, the Division of Investment Services and the Investment Committee will take into consideration the specific attributes of each foreign company before assessing its addition to any advisor's approved list.

Common stocks eligible for investment shall be approved by the Investment Committee prior to purchase. A list of approved stock investments shall be maintained by the Investment Division for each advisor's fund as established by the Committee. Said lists shall at all times meet the investment criteria heretofore referred to and at no time shall any one list exceed 60 names. No addition or deletion from an approved list shall be made without the approval of the Committee except by the procedure of adding a name from the Master Approved List as detailed below.

1. Prior to allowing the addition of a name to an advisor's list, approval of the Chairman or the Vice Chairman of the Investment Committee or the Chief Investment Officer or Co-Chief Investment Officer of the Division of Investment Services shall be obtained.
2. If the monthly trading volume in shares of the company under consideration did not exceed three million shares in the month previous, no more than one advisor may add the name in a month by this method. In addition, if a stock has an average monthly trading volume between one and three million shares over the last 12 months no other advisor may add the name. If a stock has over three million shares per month, additional advisors would be allowed to add the name.
3. Additions under this policy will be confirmed in person at a meeting of the Investment Committee.

Sales of equities are specifically authorized by the Investment Committee with the exception that up to 15% of the equity position of the Retirement System may be sold between monthly Investment Committee meetings without prior approval. However, sales in excess of 5% of the equity position of the Retirement System must be specifically approved by the Chief Investment Officer or Co-Chief Investment Officer, Division of Investment Services and sales in excess of 10% of the equity position of the Retirement System must be specifically approved by the Chairman or Vice Chairman of the Investment Committee prior to execution by the Investment Division. At the meeting immediately following such a sale, a full report will be made to the Committee as to 1) the price obtained; and 2) whether the funds were reinvested in common stocks or being held in a short-term investment.

Real Estate

Real Estate assets of the Employees' Retirement System of Georgia are limited and restricted by law solely to the Beta Building located at Two Northside 75, Atlanta, Georgia and to real property acquired through judicial foreclosure of mortgage loans owned and held by the Retirement System at time of foreclosure, or by any other judicial or court action that assigns ownership of real property to the Retirement System. It is the policy of the Retirement System to make every effort to sell or otherwise dispose of all such property except that of the Beta Building within five years of date of acquisition.

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May 15, 2003