

**PENNSYLVANIA PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM
INVESTMENT OBJECTIVES AND GUIDELINES
INTERNALLY-MANAGED PREMIUM ASSISTANCE PROGRAM PORTFOLIO**

I. GENERAL

The Public School Employees' Retirement Board (the Board) is responsible for formulation of investment policy for the Health Insurance Premium Assistance Program (Program). The Program is a medical assistance program offered by the Board and the custodian of the Program's assets is the State Treasurer of the Commonwealth of Pennsylvania. The Board, as trustee for the Program, has exclusive investment control of the Program, and shall invest the moneys in the Fund as authorized by the laws of the Commonwealth of Pennsylvania. Part of this responsibility includes development of investment policy, informed selection and retention of investment advisors, and ongoing monitoring of investment results.

II. OBJECTIVES

This actively managed U.S. fixed income portfolio will consist primarily of fixed income investments and cash equivalents. The objectives of this portfolio are:

1. to preserve capital;
2. to maintain low price volatility relative to the Merrill Lynch 3-Month Treasury Bill Index (Index):
3. to generate positive annual returns in excess of the Index; and
4. to maintain an information ratio of 0.00 or greater per year over a rolling 3-year period.

The investment manager is expected to adhere to the investment philosophy and style that was presented to the Board, Investment Office Staff, and Investment Consultant at the time of its hiring and as set forth in his employment with the Board.

Quarterly performance shall be evaluated to monitor progress toward attainment of these goals. It is understood that there are likely to be short-term periods during which performance deviates from the Index.

III. PORTFOLIO RISK MANAGEMENT

The Board's expectations are that this portfolio be actively managed within the spirit of a short-term investment pool mandate and be convertible to cash within 72 hours. Within this framework, the following are the portfolio risk constraints under which the manager is required to operate:

A. Interest Rate Risk

The effective or option-adjusted duration of the portfolio must range from zero to plus 0.50 year in excess of the Index.

B. Spread Risk

The effective or option-adjusted spread duration of the portfolio must range from zero to 0.75 year.

C. Credit Risk

1. The weighted-average credit rating of the portfolio must be Aa2/AA or better.
2. Commercial paper issuers and negotiable certificates of deposits rated P-1/A-1 or better are acceptable. Commercial paper rated P-2/A-2 is acceptable provided the long term rating is at least A3/A-.
3. Securities other than commercial paper issuers and negotiable certificates of deposits must be rated A3/A- or better.
4. Money market funds that are not registered with the Securities and Exchange Commission are prohibited.
5. Repurchase agreements will have terms no greater than 90 days and will be secured by at least 102% of Federal Obligations collateral.

Note: Credit ratings shall include ratings issued by Moody's, Standard & Poor's, and Fitch Investor Service (hereafter referred to as the "Credit Rating Agencies"). If each of the Credit Rating Agencies assigns a credit rating, the credit rating will be the middle of the three ratings (for example, if Moody's rates a security Baa2, S&P rates a security BB+, and Fitch rates a security BBB-, the middle credit rating would be considered BBB- by Fitch). If only two of the three Credit Rating Agencies assign a credit rating, the credit rating will be the lower of the two. If only one of the Credit Rating Agencies assigns a credit rating, that credit rating will apply.

The rating for the internally-managed PSERS Short-Term Investment Pool is considered Aaa/AAA for credit rating purposes.

D. Currency Risk

1. At no time may the manager's portfolio invest in securities denominated in foreign currencies.

E. Sovereign Risk

1. No more than 15% of the portfolio may be invested in dollar-denominated non-U.S. government securities and dollar-denominated bonds issued by non-U.S. domiciled entities. Non-U.S. exposure will be determined based on the issuer of the underlying instrument.

F. Concentration Risk

1. No more than 7% of the portfolio at market value may be invested in the securities of any issuer (excluding issues or issuers fully guaranteed by the U.S. Government and its agencies rated Aaa/AAA and securities issued by non-US. Governments).
2. Non-convertible preferred stock and convertible bonds (bonds convertible into common stock) are prohibited.
3. No more than 5% of the portfolio at market value may be invested in asset backed securities (defined as financial instruments collateralized by one or more types of assets including mortgages, receivables, loan paper, etc.), rated below AA3/AA-. This limit does not apply to U.S. or U.S. agency guaranteed asset backed securities.
4. No more than 10% of the market value of the portfolio invested in municipal securities.
5. No more than 15% in any one sponsor of money market funds.
6. Reverse repurchase agreements are prohibited.

G. Liquidity Risk

Positions in letter stock, private placements (excluding 144A securities), physical real estate, physical commodities, and any other positions unable to be liquidated promptly without severe market impact are prohibited.

H. Counterparty Risk

1. Counterparties to repurchase agreements must be members of the Federal Reserve System and insured by the FDIC.
2. Exposures to any counterparty will not exceed 20% of the market value of the portfolio.

IV. GENERAL

A. Derivatives

Unless written permission is obtained from the Chief Investment Officer (CIO) or unless otherwise specified in these guidelines, derivative investments, including but not limited to, forwards, futures, interest only and principal only strips, options, swaps, structured notes, swaps, etc. are prohibited.

B. Commissions

Best efforts shall be used to execute trades and all new issue designations with the System's Commission Recapture Agent. National Association of Securities Dealers' rule 2740, "Selling Concessions, Discounts, and Other Allowances," regarding new issue designations preclude the remittance of selling concessions recaptured to be remitted to the System. Those selling concessions, however, may be used to pay for qualified investment research.

C. Mutual/Commingled Funds and Unit Investment Trusts

Mutual funds (both closed and open-ended), Commingled Funds, Unit Investment Trusts, ETFs, or any equivalent fund type funds are prohibited investment vehicles without the written permission of the CIO.

D. Market-Driven Breaches

PSERS recognizes that the portfolio will always be subject to fluctuations in market value. Market-driven breaches of the guidelines (breaches that occur due to market fluctuations) shall not be considered a violation of the guidelines as long as the Investment Manager corrects these breaches within 10 business days of the breach (unless an extended period of time is granted elsewhere in the guidelines and/or written permission is received from the CIO providing an extended period of time). Active breaches (breaches that occur due to purchase and sale activity) shall be considered a violation of the guidelines and must be corrected as soon as prudently possible. Consistent patterns of active breaches may be cause for termination.

V. AMENDMENTS

A written request to the CIO and Deputy Chief Investment Officer (DCIO) should be made if the manager believes that these portfolio risk constraints significantly limit the ability of the manager to achieve the objectives of the portfolio. A written amendment will be issued from the CIO, or the DCIO in the CIO's absence, if the request is approved.

VI. COMMUNICATIONS

The Board requires continual awareness of the System's activity and position, both absolute and relative. To accomplish this, the following shall be provided by the public market investment manager:

- A. Promptly -
 - 1. When requested by the Staff - a complete listing of all holdings, pending trades, transaction history and any additional related information.
 - 2. Notification to the CIO, the DCIO, and the Compliance Officer of any compliance exceptions as they relate to these policies and applicable amendments.
 - 3. Notification to the CIO, DCIO, and the Compliance Officer of any material personnel or organizational changes that could affect the management of the System's portfolio.
- B. Daily - To the Custodian Bank, Investment Accounting (IA), and the Investment Accounting Application Service Provider (IAASP):
 - 1. On a daily basis all trades, including foreign currency exchange transactions, must be sent via e-mail to IA and IAASP in a Microsoft Excel-readable formatted file. The trade file should include, but not be limited to, the following: Custodian Account Number, Buy/Sell indicator, Broker Identification Code, Broker Name, Trade Date, Settle Date, Ticker, CUSIP, Security Description, Shares, Price, Principal, Commission, Fees, and Net Amount (all monetary amounts to be provided in base and local currency).
- C. On an as needed basis - information for the State Treasurer's staff to perform their pre-audit function.
- D. Monthly - To the Investment Consultant, CIO, DCIO, Compliance Officer, and IA:
 - 1. End of month valuations in accordance with the System's requested format or, if PSERS does not request a specific format, the Investment Manager's usual format, containing cost and market valuations by security (including FX forward and spot positions), holdings by sector segmentation, transaction summary register (purchases, sales, dividends/interest, other distributions/receipts), and holdings by country, with cost and market valuation in local currency and in U.S. dollar terms. These reports shall be in electronic form (i.e. Microsoft Excel, Adobe Acrobat files, etc.) and

shall be sent via e-mail to the System and the System's general or designated Investment Consultant unless written permission is received from the CIO to send reports other than by e-mail.

E. Monthly - To the DCIO, Compliance Officer, and IA:

1. Performance reports for the month, quarter-to-date, year-to-date, rolling one-year, rolling three-year, and portfolio-to-date (since inception) as well as the benchmark performance figures for each of those periods. Information is to be sent via e-mail to a designated Internet address within five business days from the end of each month.

F. Monthly - To Custodian Bank, IA, and IAASP:

1. Each Investment Manager is required to complete a month-end reconciliation of its account balance to the balance per the Custodian Bank. A reconciliation template in the form of a Microsoft Excel spreadsheet shall be sent via e-mail from the Custodian Bank not later than the seventh business day of the following month. The Investment Manager is required to transmit its reconciliation via e-mail to the Custodian Bank and IA by the third business day (not later than the tenth business day of the following month) following receipt of the reconciliation template. The Custodian Bank in those cases where there are variances between the Investment Manager and the Custodian Bank above a certain threshold and the Custodian Bank is deemed to be incorrect will issue a letter restating the month-end net asset value of the account. Restated net asset values will be used for performance and billing purposes.
2. The final or closed account holdings and amounts, including cash and pending trades, must be sent via e-mail to IA and IAASP in a Microsoft Excel-readable formatted file. The holdings spreadsheet should include at least the following headings and information: custodian account number, CUSIP, security description, shares, base cost, local cost, base market value, and local market value.

G. Quarterly - To the DCIO and Compliance Officer:

1. Provide written confirmation of adherence to these Investment Objectives and Guidelines in the format provided by the System within 30 days after the end of each calendar quarter. Consistent patterns of failing to complete the compliance certifications within 30 days after the end of each calendar quarter may be cause for termination.

2. Provide a detailed attribution of returns for the portfolio for the previous quarter and year versus the established benchmark for the portfolio within 30 days after the end of each calendar quarter.

H. Other - To the Investment Consultant, CIO, and DCIO:

Immediate telephone and/or letter advice should be forthcoming from the Investment Manager when information of an important nature, such as a change in ownership of the advisor, a change in the portfolio manager(s) managing the System's portfolio, or unusual market activity (oil embargo, monetary crisis, etc.) that is causing, or may cause, material impact on the System.

If at any time the Investment Manager feels that the objectives cannot be met, or the guidelines constrict performance, the CIO should be notified in writing. The Investment Manager shall be encouraged to suggest changes in these guidelines as necessary. By signature the Investment Manager agrees to these Investment Objectives and Guidelines and shall perform in accordance therewith.

Pennsylvania Public School
Employees' Retirement System

Portfolio Manager Signature

Chief Investment Officer

Portfolio Manager Name

Date Accepted

Date Proposed