I. OBJECTIVES

This actively managed LIBOR-Plus short-term investment pool will consist of fixed income investments and cash equivalents. The objectives of this portfolio are:

1. to preserve capital;
2. to maintain low price volatility;
3. to generate positive annual returns in excess of the implied financing costs of derivative positions (3-month LIBOR); and,
4. to generate those excess returns with an Information Ratio of 0.30 or greater over a rolling 3-year period.

II. PORTFOLIO RISK MANAGEMENT

The Board's expectations are that this portfolio be actively managed within the spirit of a LIBOR-Plus short-term investment pool mandate. 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 0.75 year.

B. Spread Risk

The effective or option-adjusted spread duration of the portfolio must range from zero to 1.0 year.

C. Credit Risk

1. The weighted-average credit rating of the portfolio must be Aa3/AA- or better.
2. Commercial paper issuers and negotiable certificates of deposit rated P-2/A-2 or better are acceptable. Commercial paper rated P-3/A-3 is acceptable provided the long-term rating is at least Baa3/BBB-.
3. Securities other than commercial paper issuers and negotiable CDs must be rated Baa3/BBB- or better.
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/AA 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 20% 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. The portfolio may hold up to 5% of the portfolio at market value in convertible bonds (bonds convertible into common stock) that are trading at 105% of par value or less. When convertible bonds are trading at more than 105% of par value, the manager must sell within 60 days or receive written permission from the CIO to continue to hold the security.

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 A3/A-. 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.

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. Derivative Counterparty Risk

1. The commercial and investment banks used for approved OTC futures or approved OTC options, must be rated A3 or better by Moody’s Counterparty Ratings, (if not rated by Moody’s, then rated A- or better by Standard and Poor’s Counterparty Ratings or rated B or better by Fitch’s Bank Individual Ratings).

2. Net forward contracts, futures contracts and option exposures to any counterparty will not exceed 20% of the market value of the portfolio. Exposure is measured in net U.S. dollar equivalent terms (offsetting contracts will be netted for this purpose).

3. Counterparty limits will not be applied to listed futures and options.

III. DERIVATIVES

The portfolio is permitted to establish and maintain long and short positions in:

1. Listed options on fixed income futures; and,
2. Fixed income forward commitments, including mortgage dollar rolls; and,
3. Listed fixed income futures contracts.

Fixed income derivatives may only be used to manage interest rate risk.

IV. AMENDMENTS

A written request to the Chief Investment Officer (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.