BOARD OF TRUSTEES
UNIVERSITY OF PUERTO RICO

CERTIFICATION NUMBER 30
2007-2008

I, Salvador Antonetti Zequeira, Secretary of the Board of Trustees of the University of Puerto Rico, DO HEREBY CERTIFY THAT:

The Board of Trustees, in its regular meeting of January 19, 2008, upon the recommendation of its Financial Affairs Committee and the advice of its Investment Consultant, amended and approved the:

> **Statement of Investment Policy, Guidelines and Objectives for the Investment Fund of the University of Puerto Rico Retirement System, that is attached and incorporated to this Certification;**

and provided that:

> **The Statement of Investment Policy as amended and approved hereby, supersedes all previous statements on this matter, and renders ineffective all such previous statements and their amendments on the date of approval of this Certification.**

Issued under the seal of the University of Puerto Rico, this 23 day of January, 2008.

Salvador Antonetti Zequeira
Secretario

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BOARD OF TRUSTEES
UNIVERSITY OF PUERTO RICO RETIREMENT SYSTEM

STATEMENT OF INVESTMENT POLICY, GUIDELINES AND OBJECTIVES

CERTIFICATION NO. 30 (2007-2008)
JANUARY 19, 2008

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ADOPTION OF THE STATEMENT

The Board of Trustees, on the advice of the Consultant, hereby adopts this Statement of Investment Policy, Guidelines, and Objectives ("Statement") for the Investment Fund of the University of Puerto Rico Retirement System. The Statement is hereby incorporated into all existing and any future Investment Manager Agreements.

INTRODUCTION AND DEFINITIONS

A. The University of Puerto Rico Retirement System

The University of Puerto Rico Retirement System ("the Retirement System", "the System") was originally established on January 1, 1945, pursuant to Law #135 of May 7, 1942, and has maintained its operations pursuant to Law No. 1 of January 20th, 1966, as amended, known as the ''Law of the University of Puerto Rico.''

The University of Puerto Rico Retirement System is a defined benefit pension plan covering substantially all full-time employees contracted for a period of over nine (9) months by the University of Puerto Rico. It is qualified and exempt from Commonwealth of Puerto Rico and United States of America taxes.

The fundamental purpose of the University of Puerto Rico Retirement System is to provide benefits to the participants, and enable them to accumulate reserves for themselves and their dependents to meet the risks of disability, death, employment termination, and advancing age. The System also assists the U.P.R. to reach the objective of attracting persons to render professional services to the University, therefore enhancing all aspects of service, including academic and administrative.

B. Board of Trustees

The Board of Trustees of the University of Puerto Rico ("the Board") is the governing board of the University. The Board is the System's trustee and fiduciary pursuant to the Law of the University of Puerto Rico, as amended by Law No. 16 of June 16, 1993.

C. Financial Affairs Committee

The Financial Affairs Committee ("the Finance Committee") is the managerial committee of trustees appointed by the Board to oversee all operational and administrative aspects of the System.

D. Board of Advisors ("Retirement Board")

The Board of Advisors, or the Retirement Board, represents the System's participants and pension recipients, and is directly responsible to the Board of Trustees. Its members are the Director of Finance of the University of Puerto Rico ("U.P.R.") (ex-officio-member), and elected members from the U.P.R. eleven (11) academic units, the U.P.R. Central Administration and the System's current pension recipients.

E. Executive Director of the System

The Executive Director of the System is charged with the administration of the System's operations, and is named by and reports to the Board of Trustees.

F. Investment Consultant

The Investment Consultant, hereinafter called "the Consultant," shall be a professionally qualified company possessing the necessary specialized research capability and skilled work force to provide objective, impartial, investment counseling. The Investment Consultant shall be engaged by the Board.

G. Investment Manager

The Investment Manager(s), hereinafter called "the Manager," shall be one or more professionally qualified firms possessing the necessary specialized research facilities and skilled work force of securities portfolios. The Manager shall be a Registered Investment Advisor(s) under the Investment Advisors Act of 1940, and shall be engaged by the Board.

H. Investment Fund

The Investment Fund, hereinafter called "the Fund" comprises the liquid assets of the System.

PURPOSE OF THE STATEMENT

The purpose of this Statement is to foster an effective working relationship with the Fund's investment managers through a discipline of good communication. The Statement is intended to provide the Board with a foundation from which to understand specific management styles and strategies, so that the Board can effectively evaluate the performance of the investment managers and oversee the management of the Fund in a prudent manner.

This statement of investment policy is not intended to remain static. Periodically, the Board will review this Statement and, if deemed advisable, amend this Statement. In addition, the Retirement Board, from time to time, may recommend changes to the Board. Recommendations from investment managers for improving policies, procedures, and operations are always welcome.

This Statement also is adopted in order that the Board of Trustees, the Financial Affairs Committee, the Retirement Board, the Executive Director, the Investment Consultant, the Manager(s) and all other advisors to the System have a clear and mutual understanding of the investment objectives and policies of the Fund and create a framework for realistic expectations regarding behavior and result which are expected to occur during various stages of a market cycle.

The Statement sets forth the following:

1. The investment policies and objectives and performance criteria for investment manager(s).
2. A guideline for the Board's ongoing supervision of the investment of Fund assets to ensure that the Fund's investments remain invested in accordance with this Statement.
3. A recognition that the financial health of the System cannot be assured by relying solely on increasing investment income; that contributions and expense levels must also be periodically examined
4. Accounting and Reporting Guidelines for the purpose of measuring the performance of all investment managers.
5. Directed Brokerage Policy.
6. Proxy Voting Policy.

GENERAL POLICIES AND PROCEDURES

A. Duties and Responsibilities

Board of Trustees

The Board of Trustees has the responsibility for establishing and maintaining investment policy that guides the investment of the Fund. Based on the recommendations of the System's actuaries and the Finance Committee, the Board will approve the necessary investment framework and actuarial assumptions to evaluate the health of the Fund and to determine retirement benefits. The Board is responsible for making judgments on specialized professional services contracted by the Finance Committee. The Board will receive reports from the Finance Committee and evaluate recommendations made by the Committee regarding all matters relating to the structure and investments of the System. The Board shall discharge its duties with care, skill, prudence and diligence under circumstances then prevailing, which a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims. The Board shall accomplish these goals, in part, by diversifying the investments of the Fund with the goal of minimizing the risk of large losses, unless under specific circumstances it is clearly not prudent to do so.

Finance Committee

The Board of Trustees has the responsibility for establishing and maintaining reasonable investment objectives in accordance with the general norms established by the Board. The Finance Committee shall review and maintain the Fund's strategic asset allocation as well as regularly evaluate each manager's performance and adherence to the investment guidelines as outlined in the Investment Policy Statement. The Finance Committee is responsible for evaluating and making recommendations to the Board regarding selection and replacement of the Consultant, Manager(s), Custodian, and Trustee. The Finance Committee shall inform the Board in writing, at least once per quarter, or as required, about all matters related to the System. The Finance Committee shall discharge its duties with care, skill, prudence and diligence under circumstances then prevailing, which a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims.
The Finance Committee is primarily responsible for the following:

- Maintaining investment policy
- Establishing a strategic asset allocation
- Advising the Board on hiring and firing of portfolio managers, investment consultants and custodians
- Review and monitoring of investment managers
- Monitoring of investment costs
- Delegating the execution and administration of policy to staff

- Reporting to the Board on investment performance, policy recommendations, asset allocation, and any other matters relating to the System.

The Finance Committee understands that regarding implementation of the investment policy, their role is to supervise, not execute, and that decisions about investment strategies and the selection of securities will be delegated to the Manager, in accordance with the policies described in this document. Nevertheless, the Finance Committee reserves the right to study and recommend to the Manager investments to be explored or that appear to be valuable to the System.

Retirement Board

The Retirement Board may submit to the Finance Committee those policies it deems advisable regarding Fund investments and may advise the Committee regarding any other matters related to the System, upon the Committee's request or its own initiative.

Executive Director

The Executive Director and its staff will prepare recommendations for the Finance Committee and the Board action on issues affecting the Fund. The Executive Director will also interact with the Fund's consultants on a day-to-day basis and assist them in reporting to the Retirement Board, the Finance Committee, and the Board on a regular basis.

Investment Consultant

The Board may retain an objective, third-party performance measurement consultant to monitor the performance of the Fund and the individual managers relative to the objectives and benchmarks set forth in this statement. The performance measurement consultant will provide quarterly reports and will meet with the Board, Finance Committee, and staff as needed, to provide analysis and interpretation of performance. The Board will be entitled to rely on such consultant. The Consultants will assist the Board and the Finance Committee in formulating and administering investment policy, analyzing existing investments, selecting new investment managers and educating the staff, the Finance Committee and Board on investment issues, capital markets, and fiduciary responsibilities.
The Investment Consultant is responsible for facilitating the following processes:

A. Assuring a clear understanding by all parties of:
   1. The System's financial obligations,
   2. A basic understanding of the fiduciary responsibilities of the Board, the Consultant and the Manager(s), and
   3. A practical comprehension of the capital markets, so that investment decisions reflect sound management of the System's assets.

B. The on-going review of the System's Statement of Investment Policy Guidelines and Objectives, to insure that it adequately reflects the investment philosophy, strategies, objectives, and guidelines subscribed to by the Board.

C. The on-going examination of the System's investment portfolios, to insure the attainment of the System's investment objectives over market cycles.

D. The on-going due diligence of the Manager(s), in order to insure:

1. Adherence to the investment style for which the Manager was hired.
2. That the quality of the Manager remains high, relative to its investment style, peer group, infrastructure, and performance.
3. That the general policies set forth by the Manager in implementing strategy for the System (trading practices, portfolio manager turnover, broker/dealer selection, etc.) reflect the highest standards of integrity and ethical conduct.

E. On-going performance measurement, to insure:

1. That investment performance of each Manager contributes positively and adequately to the overall performance of the Systems' assets, relative to its investment style, peer group, and the System's investment objectives. It is important to note that performance consists of two variables: return and risk. It is this risk/return ratio, which shall be continually measured.
2. That the sources of investment performance, such as security selection, asset allocation, sector distribution, investment styles, and other criteria are appropriate relative to the Board's investment philosophy, the guidelines stated herein, and add value in the investment process.

Investment Managers

Assets will be allocated to professional investment managers in accordance with manager structure policy. The individual managers will be judged according to benchmarks that reflect the objectives and characteristics of the strategic role their portfolio is to fulfill.
In recognition of their roles as fiduciaries of the Fund, the investment managers assume the following responsibilities:

- To invest with the same care, skill, prudence and due diligence under the circumstances then prevailing, that an experienced, professional investment manager acting in a like capacity and fully familiar with such matters, would use in the investment of like assets with like aims.
- To exercise investment discretion (including holding cash equivalents as an alternative) within the policy objectives and guidelines set forth herein. Such discretion includes decisions to buy, hold, or sell securities in amounts and proportions reflective of the manager's current investment strategy and that are compatible with the policy objectives and guidelines.
- To avoid all conflicts of interest when using Fund assets to pay brokerage expenses and to ensure that all trading expenditures are made for the benefit of the Fund. To monitor trading costs and obtain best execution. The use of soft dollars is prohibited for the purpose of paying investment manager fees.

- To comply with all appropriate objectives and guidelines pertaining to their role, asset class, and vehicle type.

Custodian

The Finance Committee may recommend the Board to appoint an independent custodian to hold the Fund's assets and to ensure their safekeeping. The appointment of an independent custodian is an effective way to safeguard the physical and legal integrity of the assets. The custodian should not be able to absolve itself of its responsibility by entrusting to a third party all or some of the assets in its safekeeping. The Finance Committee may also recommend the Board to appoint the custodian to provide additional services such as securities lending, cash management, investment accounting and reporting, and performance measuring.

B. Policy on Establishing and Maintaining the Strategic Plan

A successful investment program must be based on a strategic plan that clearly defines the purpose, goal, and objectives of the assets under management. Specifically, the Board must define the return it needs to meet its objectives and the risk it is willing to take in order to achieve those returns, as well as the time horizon during which it will evaluate the results. The strategic plan will define the most suitable asset class structure that will result in the highest expected rate of return to a given level of risk considering all appropriate investment vehicles within applicable legal and investment guidelines. In keeping with the investment objectives articulated in this document, the Committee will establish a strategic plan for investing the assets over a full market cycle. This plan will be reviewed by the Retirement Board, the Finance Committee, and the Consultant at the beginning of each fiscal year to determine if they should recommend the Board to modify the plan given the existing circumstances, and the long-term prospects for the capital markets.

C. Manager Selection and Termination

Procedures for Manager Selection

The Board agrees that the Manager(s) must meet the following general criteria for eligibility:

1. The Manager shall be duly registered under the Investment Advisors Act of 1940.
2. The Manager shall be a substantial, financially viable organization with superior equity and/or fixed income securities management, capable of supporting an investment process and delivering consistently superior returns. This includes superior risk-adjusted performance relative to the capital markets and the Manager's peer group, style and strategy, for seven years and five years, as well as the trailing twelve (12) months.
3. The Manager shall have a clearly defined organizational structure with staffing facilities and operations capable of supporting the investment

activities and servicing requirements of the System. It is expected that the organization is stable with minimal turnover.

4. The Manager shall have a record of accomplishment of at least one year established by the manager or management team that will be responsible for the Fund’s portfolio with the key people in the organization having at least three years of experience managing assets in a similar style and particularly managing portfolios for public retirement funds. Ability to provide historical time-weighted quarterly returns gross & net of fees for a composite of similar accounts along with a published fee schedule.
5. The Manager shall acknowledge in writing its recognition and acceptance of full responsibility as a fiduciary under applicable federal and local laws.
6. Funds placed with the Manager shall not constitute more than 10% of total assets under its management, unless specifically approved by the Board.
7. The Manager shall have a philosophy and investment strategy that is clearly articulated and has been consistently applied over time.
8. The Manager shall have an investment process including buy and sell disciplines that are explicitly defined and rigorously executed.
9. The Manager shall have a track record of at least three years established by the manager or management team that will be responsible for the Fund’s portfolio with the key people in the organization having at least five years of experience managing
10. The total number of accounts managed by each portfolio manager will be of consideration.
11. The Manager shall restrict its investment activity to those securities and to such asset allocation and other guidelines as stated herein.
12. Any sanctions and/or investigations, past or pending, against the Manager by the Securities and Exchange Commission or any court of law, or any other relevant ruling body during the five (5) years prior to the date of consideration shall be closely evaluated.
13. The Manager shall provide written policy statement regarding current trading and soft dollar practices.

Investment managers employed by the Fund will be selected through a thorough review process, which will include all or some of the following steps:

- Formulation of specific manager search criteria that establish the qualifications for the manager’s role.
- Identification of qualified candidates from the Finance Committee, and/or the manager search database maintained by the Fund's investment consultant.
- Complete due diligence on each candidate that will include performance screening, qualitative screening and/or onsite visits.

- Selection and interview of finalist candidates based on final results of the due diligence process.

To ensure that the Fund is meeting its objective, the Finance Committee will review the investment options and their respective investment performance on a quarterly basis acknowledging that fluctuating rates of return characterize the securities markets, particularly during short-term time-periods. Recognizing that short-term fluctuations may cause variations in a portfolio's performance, the Finance Committee intends to employ investment managers with long-term investment strategies and will evaluate manager performance from a long-term perspective.

The Finance Committee will determine what information will be used to review investment options, what information will be retained, and how it will be retained. Non-generic performance review and other evaluative materials provided by the Investment Consultant for all of the investment options available may be used to assist in the review process and may become a part of the records maintained regarding the selection and monitoring of the designated investment alternatives and asset managers.

The Finance Committee believes it is in the best interest of the participants and beneficiaries to establish specific performance objectives for each investment category. The performance of each individual option will be evaluated relative to a market index and to a meaningful peer group of actively managed funds. Each alternative's return is expected to exceed the return of its specified benchmark and the median of its specified peer group over rolling three- year and five-year time-periods, respectively.

In addition, managers will be evaluated for consistency of investment approach and adherence to stated guidelines. Managers that fall below benchmarks or fail to adhere to their investment style will be evaluated in accordance with the review procedures outlined in the next section of this policy.

Procedures for Manager Termination

In evaluating the Fund's investment managers, the Finance Committee will consider qualitative factors likely to impact the future performance of the portfolio in addition to current and historical rates of return. The Finance Committee acknowledges that, as a result of exercising its fiduciary duty to monitor the Fund's assets, it may from time to time need to give consideration to replacing managers that are not achieving expected performance. The Finance Committee at its discretion will recommend to the Board when to terminate or add managers. The Finance Committee has deemed it appropriate to include "objective standards" designed to guide future decisions about manager termination.

The standards, noted below, are not to be mechanically applied. Rather, if an investment manager seemingly fails to meet any one of the following three standards, then subject to a thorough review of the manager's organization and investment process, the Committee may decide to terminate a relationship. The standards include:

- Extraordinary Events (Organizational Issues).
  - Changes in ownership.
  - Changes in professional staff.
  - Changes in investment strategy or process.

- Client service problems.
- Significant account loss or significant rapid growth of new business.
- Manager involved in material litigation or fraud.

- Performance below the median of the appropriate peer group for any period longer than two years. Absent any change in organization or strategy, managers should be given a defined and specified market cycle to achieve performance. However, near-term under-performance, especially relative to peer groups can be an early warning sign, and it is appropriate to initiate a review even after a year to determine if there are factors that make a recovery unlikely.
- Performance below the manager's market index, after fees, over any five-year period.

A formal manager evaluation may include the following steps:

1. A letter to the manager stating the reasons for the formal review, the steps of the review and the possible results (retain or terminate).
2. An analysis of recent transactions, holdings, and portfolio characteristics to determine the cause of under performance or verify a change in style.
3. A meeting with the manager to gain insight into organizational changes and any changes in strategy or discipline.

Ultimately, the decision to retain or terminate a manager cannot be made by a formula. It is a judgment that turns on the Finance Committee's assessment of the firm's ability to perform in the future. In general, managers should be retained if the Finance Committee determines that, in the manager's strategy, discipline, and process, the manager will continue to fulfill the role for which the manager was hired and has a high probability of achieving performance targets within a reasonable time frame.

D. Securities Lending

Securities lending is permitted as an opportunity to earn additional income. The policies and guidelines governing securities lending shall be with the master custodian, unless contracted otherwise. A separate contract, distinct from a master custody relationship, detailing the type of securities lending relationship and program is both mandatory and essential in the treatment of securities lending as, foremost, an investment function with the associated risks and return implications, and fiduciary responsibility. No securities owned by the System, but held in custody by another party, will be loaned unless a separate written agreement has been approved by the Board.

Securities lending enables the System to use its asset base to augment investment income. It involves the temporary exchange of securities owned by the System for other securities or cash of a greater value, with an obligation of the borrower to pay a fee to the Fund, and to return a like quantity of the borrowed securities at a future date. The fee paid by the borrower is agreed in advance, while the System has contractual rights similar to those it would have as the beneficial owner of the securities except that the System does not retain voting rights on loaned equity securities.

The objective of securities lending is to earn income through a conservatively operated and well-controlled program. There is no absolute return expectation; rather, income is expected commensurate with the market demand for the securities made available by the System and the return earned on the investment of cash collateral. Cash collateral received will be invested in a high-quality investment program that emphasizes the return of principal, maintains required daily liquidity, and ensures diversification across approved investment types. Those objectives are pursued within the parameters governing the program as outlined in the securities lending agreements with agent banks. Each agent bank is required to act as a fiduciary with respect to the Fund, and to have systemic and procedural controls in place to ensure adherence to guidelines for operating the securities lending program on behalf of the System. The results of the securities lending program are reported to the Board on a regular basis.

E. Procedures for Monitoring and Evaluating the Investment Program

The investment consultant working with the Board and Finance Committee will be responsible for monitoring the activities of the investment managers on an ongoing basis and for recommending modifications or enhancements, which the investment consultant believes will improve the performance of the program. In addition to maintaining the regular communication with managers, the investment consultant and Finance Committee will schedule regular review meetings with each investment manager to evaluate historical performance against guidelines and objectives and discuss the firm's outlook for the following year. The agenda of these meetings will include:

- A review and reappraisal of each manager's investment program including the manager's compliance with the objectives and guidelines set forth herein. This should include a discussion of any recommendations for changes to these guidelines and the underlying rationale for same.
- Commentary on investment results in the context of the appropriate standards of performance as stated in this document.
- A synopsis of the key investment decisions, their underlying rationale, and how they may affect future results.
- A discussion of each manager's economic outlook, the specific investment decisions that this outlook may trigger, and how these decisions may affect future results.

Meetings, in addition to the regular review, will be scheduled when deemed necessary for such reasons as significant underperformance relative to the corresponding style benchmark for three consecutive quarters, or, any changes in personnel, ownership or investment style which could affect the firm's future performance.

F. Review Procedures

The Finance Committee and the Investment Consultant shall review this Investment Policy Statement periodically to determine if modifications are necessary or desirable. If the Board modifies this Statement, it will promptly notify all Investment Managers and other interested persons of the changes.

TOTAL FUND

A. Strategic Asset Allocation

One role of the Board is to attempt reasonably to maximize the benefits to be gained from the investment process. With this in mind, a strategic asset allocation has been established based on the principle that individual asset classes have different investment characteristics and that asset classes can be combined to optimize the objectives of the Fund. The goal of this strategic asset allocation is a Fund that is efficient, well diversified, and manageable over the long-term. The benefits of this diversification are reduced risk and improved investment returns.

This strategic plan for investing the assets of the Fund has been established with a time horizon of three to five years. The Board and the Finance Committee will review this plan at least every 3- to 5- years to determine if it should be modified given existing and anticipated circumstances in the condition of the Fund and the prospects for the capital markets.

The Board has currently adopted the following strategic asset allocation:

Asset Class	**% Allocated**	**Range**
Domestic Large Cap Equity	40%	±5%
Domestic Small/Mid Cap Equity	10%	±3%
International Equity	10%	±3%
Fixed Income	28%	±5%
Loans and Mortgages	12%	±3%

- The overall Fund does not have a strategic allocation to cash but individual managers will hold varying amounts of cash within their respective portfolios as part of the normal course of managing their portion of the Fund. This is specifically addressed within the individual asset class guidelines that follow.

- The overall Fund does not have a strategic allocation to private equity. However, the Fund may, from time-to-time, examine private equity investments that it deems acceptable. If an allocation is made, it will be funded from the domestic equity asset class. At no time, will the allocation exceed 5% of total fund assets.

B. Rebalancing Guidelines

The asset allocation of the Fund will be maintained as close to the target allocation as reasonably possible. Rapid unanticipated market shifts or changes in economic conditions may cause the asset mix to fall outside of the policy range. Cash additions and withdrawals shall be allocated across portfolios to bring the asset mix as close to the target allocation as possible.

If the asset allocation cannot be maintained within the above policy limits through cash additions or withdrawals, assets shall be shifted across investment management portfolios to restore the strategic asset allocation. Such reallocations are anticipated to occur infrequently. The consultant will be responsible for alerting the Retirement System's

Executive Director and the Finance Committee when it is necessary to rebalance the portfolios and across asset classes as necessary to conform to the adopted investment policy.

C. Manager Diversification

The Board shall ensure the presence of the various asset classes, as well as complementing investment styles within such classes. As styles cycle move in and out of favor, the Finance Committee will review style weightings and reserve the right to adjust such weightings as it deems appropriate. The Board will rely on appropriate counsel for such analyses. The Board will provide each investment manager with guidelines for the investments entrusted to them. These guidelines may be stricter or more flexible than these Policies as appropriate for the assets to be managed and the strategies to be used. Where the manager guidelines differ from these Policies, the manager shall be bound by the manager guidelines.

D. Performance Objectives for the Total Fund

The Board recognizes that the achievement of investment objectives is a long-term goal. In evaluating the overall investment performance of the Fund, the following objectives all must be considered. Not all are expected to be achieved at all times. However, achievement of each of them over time is deemed important to the success of the Fund.

1. The total return shall exceed the actuarial discount rate over the long term. The current actuarial discount rate is 8%.
2. The total return shall exceed a blended Benchmark representing both historical as well as current allocation decisions. It will be compromised of passive indices for each asset class and sub asset class represented in the asset allocation. The following is the current composition:
   - 50% Russell 3000 Index,
   - 10% MSCI EAFE Index,
   - 40% Lehman Brothers Aggregate Bond Index.
3. The Fund's overall annualized total return should perform above the median of a relevant Database.
4. Achieve a positive risk/reward trade-off when compared to other plans in a relevant Database (over a minimum 3-year period).

To the extent the Fund fails to achieve returns that meet or exceed these benchmarks and objectives, the Fund's consultant may recommend changes in the investment program to remedy the performance of the Fund over the long term.

E. Safety of Principal

The criteria of safety of principal shall not be imposed on individual investments, rather, the portfolio as a whole shall be structured to protect against long-term capital erosion.

F. Cash Flow Requirements

In addition to the Fund, the System enjoys additional resources that serve to meet its immediate cash flow requirements. Therefore, none shall be imposed on the Fund.

G. Restricted Assets and Transactions

The following investments and transactions are generally considered riskier and should be evaluated carefully before being entered into. Because of this risk, they are disallowed unless Commonwealth Government Development Bank ("GDB") is consulted in writing prior to making such investment.

1. Futures
2. Commodities
3. Options
4. Warrants
5. Private Placements
6. Unregistered or Restricted Stock

INVESTMENT GUIDELINES

A. Domestic Equity Investment Managers

Introduction

The manager is granted full discretion to buy, sell, invest, and reinvest its portion of the Fund's assets in domestic equity investments in a manner consistent with the policy and guidelines set forth in this document. Wherever these guidelines contain a limitation expressed as a percentage of the Fund or its accounts or portfolio, that percentage shall be measured solely with reference to the portion of the Fund's assets that are under the individual manager's control.

Investment Objectives

The investment objective of the domestic equity portfolios is to achieve consistent positive real returns and to maximize long-term total return within prudent levels of risk through a combination of income and capital appreciation. In accomplishing this objective, the manager shall adhere to the philosophy and style that was articulated to the Finance Committee at or subsequent to, the time the manager was hired. Any change in such philosophy and/or style must be communicated to the Finance Committee and the Retirement System's Executive Director in writing at least sixty-days (60) in advance of the change.

Performance Objectives

Due to the inevitability of short-term market fluctuations that may cause variations in the investment performance, it is intended that the performance objectives outlined below will be achieved by the investment managers over full market cycles of three to five year periods. However, the Finance Committee reserves the right to evaluate and make any necessary changes regarding the investment managers over a shorter term. Quarterly performance will be evaluated to test progress toward attainment of these longer-term goals. It is understood that there are likely to be short-term periods during which performance deviates from market indices. During such times, greater emphasis shall be placed on performance comparisons with managers employing similar styles. Minimum performance guidelines are as follows:

1. Achieve a net of fee rate of return that exceeds the appropriate benchmark over a complete market cycle (generally 3-5 years).
2. Over a minimum 3-year period, achieve cumulative performance results that rank above the 50th percentile in a relevant style group of similar investment managers, which group shall be determined by the Committee.
3. Over a minimum 3-year period, achieve a positive risk/reward trade-off when compared to other managers in a relevant style-group, which group shall be determined by the Committee.

Attainment of these objectives does not guarantee continued employment by the Fund nor does failure to achieve these guidelines ensure dismissal. Managers serve at the discretion of the Committee.

Pooled/Mutual Plan Exceptions

In the case of a commingled account or mutual fund, the Fund understands that strict adherence to the investment guidelines set forth below is impracticable. Accordingly, the Finance Committee waives such strict adherence, and the pooled/mutual plan's investment objectives, policies and restrictions, as set forth in its current prospectus and statement of additional information (as amended from time to time), shall govern the investment of the Fund's assets. The pooled/mutual fund shall also exercise prudent care in managing the portfolio.

Guidelines

The System must comply with investment restrictions imposed by the Government Development Bank for Puerto Rico Statements of Investment Guidelines for Public Retirement Plans and any other Commonwealth and federal laws dealing with investment of public retirement plan assets. All investment managers are expected to perform their fiduciary duties as prudent people would and to conform to all Commonwealth and Federal statutes governing the investment of retirement plans. Investments should primarily be in liquid, marketable securities. Separate account managers shall otherwise have full discretion, subject to the following guidelines:

- Securities managers shall be Banks or registered advisors under the Investment Advisors Act of 1940.
- The Fund's assets placed with the Manager shall not constitute more than 10% of total assets under its management, unless specifically approved by the Board.
- Portfolios are generally to remain fully invested. Managers' cash positions are not generally to exceed 5% of the market value of the portfolio. It is the responsibility of the manager to contact the Finance Committee to obtain authorization if and when it becomes clear that a cash position of more than 5% is warranted for more than 90 days.
- No single industry group shall constitute more than the greater of 25% of the market value of the portfolio, or 1-1/2 times its comparable representation in its appropriate benchmark index, without prior written approval from the Finance Committee.
- No single economic sector shall constitute more than the greater of 40% of the market value of the portfolio, or 1-1/2 times its comparable representation in its appropriate benchmark index, without prior written approval from the Finance Committee. Individual managers are not required to monitor the Fund's overall participation in any one issuer, industry, or sector.
- No single stock shall constitute more than the greater of 7% of the market value of the portfolio, or 1-1/2 times its comparable representation in its appropriate benchmark index, without prior written approval from the Finance Committee.

Individual managers are not required to monitor the Fund's overall participation in any one issuer, industry, or sector.

- The maximum Fund investment in any one company shall not exceed 5% of that company's outstanding voting stock or more than 5% in value of all outstanding shares of all classes of stock of the issuer (assuming all conversions have been made). Individual managers are not required to monitor the Fund's overall participation in any one issuer, industry, or sector.
- The manager may invest up to a total of 20% of the market value of the portfolio in ADR's.
- The equity securities of any one issuing corporation shall not exceed 20% of the investment management firm's total position across all products and clients at market at time of purchase.
- The portfolio as a whole should be managed consistent with the original mandate under which the manager was hired. No extreme position should be taken which would alter the character of the portfolio that could produce results inconsistent with that mandate.

Investment activity in the following is prohibited unless authorized in writing by the Finance Committee:

- Fixed income securities (maturities of over one year).
- Short Sales
- Margin purchases or other use of lending or borrowing money.
- Non-marketable securities.
- Non-dollar denominated securities.
- Convertible or preferred securities.
- Letter stock, private placements, or direct placements.
- Commodities.

Communication and Reporting Requirements

Investment managers shall maintain on-going communication with the Consultant in order to allow for proper execution of due diligence responsibilities. In addition, investment managers shall communicate any matters deemed relevant to the well-being of the Fund to the Consultant ant the Finance Committee in a timely matter.

Investment managers are required to provide a monthly performance report detailing all transactions and cash flows for the period to the System's Staff. In addition, investment managers are required to provide quarterly reports to the Staff and Committee. The quarterly reports must include the following:

- Reconciliation of Market Value, on a monthly basis with a summary of all discrepancies with the Custodian that have been outstanding more than 90 days.

- Performance Results for the most recent quarter, fiscal YTD, calendar YTD, year, three-year period, five-year period, seven-year period and since inception.
- Brokerage Commission Report.
- Notice of any material changes in organizational structure, ownership, key personnel, strategy, or philosophy of the firm.
- Any material litigation pending against the firm or any of its' members whether criminal, civil, or administrative.
- Certification that the portfolio is being managed in accordance with investment guidelines stated herein.

On an annual basis, the reports should include the annual filing of Form ADV with the Securities and Exchange Commission and a list of the proxy votes cast on behalf of the Fund.

Investment managers must meet with the Finance Committee as required. The Finance Committee expects to receive a written summary that responds to the subjects identified in the following agenda at least seven days prior to any such meeting. These meetings will also provide the investment managers with the opportunity to explain how their investment strategy/outlook has evolved since previous meetings.

The agenda will include the following:

- Performance for Past Period: Standard time periods for each report will be Last Quarter, Fiscal, and Calendar Year to Date, Last Year, 3 Years, 5 Years, 7 Years, and Since Inception. Returns should be annualized and calculated on a time-weighted basis for the total portfolio. All returns should include income and dividends and be footnoted as to whether they are gross or net of fees. Returns should also be measured against the appropriate benchmark.
- Rationale for Performance Results: Discussion of the rationale for performance results, relating them specifically to investment strategy and tactical decisions implemented during the current review period.
- Specific Near-Term Strategy: Discussion of the investment manager's specific strategy for the portfolio over the near-term period, with specific reference to asset mix (including cash position) and expected portfolio characteristics.
- Changes in the Investment Manager's Firm: Discussion of any changes in the investment manager's firm including, but not limited to, professional turnover, ownership changes, investment strategy, and philosophy.
- Changes in the Fund's Requirements: Discussion of any required modifications to the investment program and strategy, including changes necessary to comply with new legislation or regulation.

Brokerage Direction Policy

All domestic equity managers may be asked to participate in a directed brokerage arrangement, if any such arrangement is approved and adopted by the Board, provided, however, that notwithstanding such participation, brokerage transactions in the normal course of business should only be directed on a best execution basis. In addition, brokerage transactions should not be directed if in doing so, taking all factors into consideration, the Fund will incur a disadvantage with respect to the market price of the security. Managers are free to seek the best execution of transactions through any broker dealer. However, Managers shall not execute transactions through its affiliate broker/dealer firm, if such affiliation exist, nor shall they involve an affiliate firm, directly or indirectly, in clearing and/or settling transactions. Managers will be advised on an individual basis as to the targeted percentage of trades that shall be executed under a directed brokerage arrangement, subject to best execution. The use of soft dollars is prohibited for the purpose of paying investment manager fees.

Proxy Voting

The Board requires that the investment managers shall exercise their authority with regard to proxy voting, acting solely in the best interest of and for providing benefits to participants and beneficiaries. Further, the Board requires that the investment managers will not subordinate the interest of participants and beneficiaries to unrelated objectives. The Board further requires that the investment managers exercise their authority with regard to proxy voting consistent with the guidelines relating to shareholder activism set forth in ERISA Reg. §2509.94-2(3), and such exercise shall be deemed consistent with the interest of participants and beneficiaries.

Exceptions

Each investment manager is required to comply with the objectives and guidelines set forth in this document. The Board requires that any exceptions taken to this Statement be submitted in writing to the Board for its written approval.

B. International Equity Investment Managers

Introduction

The manager is granted full discretion to buy, sell, invest, and reinvest its portion of the Fund's assets in international equity investments in a manner consistent with the policy and guidelines set forth in this document. Wherever these guidelines contain a limitation expressed as a percentage of the Fund or its accounts or portfolio, that percentage shall be measured solely with reference to the portion of the Fund's assets that are under the individual manager's control.

Investment Objectives

The investment objective of the international equity plans is to achieve consistent positive real returns and to maximize long-term total return within prudent levels of risk through a combination of income and capital appreciation. In accomplishing this objective, the manager shall adhere to the philosophy and style that was articulated to the Finance Committee at or subsequent to, the time the manager was hired. Any change in such philosophy and/or style must be communicated to the Finance Committee in writing at least sixty-days (60) in advance of the change.

Performance Objectives

Due to the inevitability of short-term market fluctuations that may cause variations in the investment performance, it is intended that the performance objectives outlined below will be achieved by the investment managers over full market cycles of three to five year periods. However, the Finance Committee reserves the right to evaluate and make any necessary changes regarding the investment managers over a shorter term. Quarterly performance will be evaluated to test progress toward attainment of longer-term goals. It is understood that there are likely to be short-term periods during which performance deviates from market indices. During such times, greater emphasis shall be placed on performance comparisons with managers employing similar styles. Minimum performance guidelines are as follows:

1. Achieve a net of fee rate of return, which exceeds the appropriate benchmark over a complete market cycle (generally 3-5 years).
2. Over a minimum 3-year period, achieve cumulative performance results that rank above the 50th percentile in a relevant style-group of similar investment managers, which group shall be determined by the Finance Committee.
3. Over a minimum 3-year period, achieve a positive risk/reward trade-off when compared to other managers in a relevant style-group, which group shall be determined by the Finance Committee.

Attainment of these objectives does not guarantee continued employment by the Fund nor does failure to achieve these guidelines insure dismissal. Managers serve at the discretion of the Finance Committee.

Pooled/Mutual Plan Exceptions

In the case of a commingled account or mutual fund, the Fund understands that strict adherence to the investment guidelines set forth below is impracticable. Accordingly, the Finance Committee waives such strict adherence, and the pooled/mutual plan's investment objectives, policies and restrictions, as set forth in its current prospectus and statement of additional information (as amended from time to time), shall govern the investment of the Fund's assets. The pooled/mutual fund shall also exercise prudent care in managing the portfolio.

Guidelines

The System must comply with investment restrictions imposed by the Government Development Bank for Puerto Rico Statements of Investment Guidelines for Public Retirement Plans and any other Commonwealth and federal laws dealing with investment of public retirement plan assets. All investment managers are expected to perform their fiduciary duties as prudent people would and to conform to all Commonwealth and Federal statutes governing the investment of retirement plans. Investments should primarily be in liquid, marketable securities. Separate account managers shall otherwise have full discretion, subject to the following guidelines:

- Securities managers shall be Banks or registered advisors under the Investment Advisors Act of 1940.
- There shall be no investments in non-marketable securities unless authorized in writing by the Finance Committee.
- The Fund's assets placed with the Manager shall not constitute more than 10% of total assets under its management, unless specifically approved by the Board.
- Portfolios are generally to remain fully invested. Managers' cash positions are not generally to exceed 5% of the market value of the portfolio. It is the responsibility of the manager to contact the Finance Committee to obtain authorization if and when it becomes clear that a cash position of more than 5% is warranted for more than 90 days.
- No single industry group shall constitute more than 25% of the market value of the portfolio, or 1-1/2 times its comparable representation in representative index, whichever is larger, without prior approval from the Finance Committee. Individual managers are not required to monitor the Fund's overall participation in any one issuer, industry, or sector.
- No single economic sector shall constitute more than the greater of 40% of the market value of the portfolio or 1-1/2 times its comparable representation in its appropriate benchmark index, without prior written approval from the Finance Committee. Individual managers are not required to monitor the Fund's overall participation in any one issuer, industry, or sector.
- No single stock shall constitute more than the greater of 5% at book value (purchase), 10% market value of the portfolio, or 1-1/2 times its comparable representation in its appropriate benchmark index, without prior written approval

from the Finance Committee. Individual managers are not required to monitor the Fund's overall participation in any one issuer, industry, or sector.

- The maximum Fund investment in any one company shall not exceed 5% of that company's outstanding voting stock or more than 5% in value of all outstanding shares of all classes of stock of the issuer (assuming all conversions have been made). Individual managers are not required to monitor the Fund's overall participation in any one issuer, industry, or sector.
- The manager may invest in ADR's, GDR's, preferred stock, participation notes, private placements, warrants, and convertible securities when attractive opportunities exist.
- Investments in Emerging Markets are not to exceed 20% of the market value of the portfolio without prior written consent of the Finance Committee.
- The manager may invest in stock index futures for the purpose of equitizing cash.
- Subject to other restrictions listed in this section, options will be permitted for hedging purposes to the extent that they are consistent with the overall investment guidelines and do not leverage the portfolio in any way. Derivatives with payments or values that are linked to indices or assets that are inconsistent with the overall investment guidelines are not permitted.
- Stock index futures, options on futures and exchange-traded funds are acceptable investments.
- Investment managers are authorized to purchase/sell derivatives (currency forwards, swaps, futures, and options) as outlined in their specific contracts in order to hedge foreign currency exposure up to 30%, for defensive purposes only. The underlying value of the derivatives contract shall not exceed the net asset value at market.
- The portfolio as a whole should be managed consistent with the original mandate under which the manager was hired. No extreme position should be taken which would alter the character of the portfolio that could produce results inconsistent with that mandate.

Investment activity in the following is **prohibited** unless authorized in writing by the Finance Committee:

- Fixed income securities (maturities of over one year).
- Short Sales
- Margin purchases or other use of lending or borrowing money.
- Non-marketable securities.
- Commodities.

Communication and Reporting Requirements

Investment managers shall maintain on-going communication with the Consultant in order to allow for proper execution of due diligence responsibilities. In addition, investment managers shall communicate any matters deemed relevant to the well-being of the Fund to the Consultant ant the Finance Committee in a timely matter.

Investment managers are required to provide a monthly performance report detailing all transactions and cash flows for the period to the System's Staff. In addition, investment managers are required to provide quarterly reports to the Staff and Finance Committee. The quarterly reports must include the following:

- Reconciliation of Market Value, on a monthly basis with a summary of all discrepancies with the Custodian that have been outstanding more than 90 days.
- Performance Results for the most recent quarter, fiscal YTD, calendar YTD, year, three-year period, five-year period, seven-year period and since inception.
- Brokerage Commission Report.
- Notice of any material changes in organizational structure, ownership, key personnel, strategy, or philosophy of the firm.
- Any material litigation pending against the firm or any of its' members whether criminal, civil, or administrative.
- Certification that the portfolio is being managed in accordance with investment guidelines stated herein.

On an annual basis, the reports should include the annual filing of Form ADV with the Securities and Exchange Commission and a list of the proxy votes cast on behalf of the Fund.

Investment managers must meet with the Finance Committee as required. The Finance Committee expects to receive a written summary that responds to the subjects identified in the following agenda at least seven days prior to any such meeting. These meetings will also provide the investment managers with the opportunity to explain how their investment strategy/outlook has evolved since previous meetings.

The agenda will include the following:

- Performance for Past Period: Standard time periods for each report will be Last Quarter, Fiscal, and Calendar Year to Date, Last Year, 3 Years, 5 Years, 7 Years, and Since Inception. Returns should be annualized and calculated on a time-weighted basis for the total portfolio. All returns should include income and dividends and be footnoted as to whether they are gross or net of fees. Returns should also be measured against the appropriate benchmark.
- Rationale for Performance Results: Discussion of the rationale for performance results, relating them specifically to investment strategy and tactical decisions implemented during the current review period.
- Specific Near-Term Strategy: Discussion of the investment manager's specific strategy for the portfolio over the near-term period, with specific reference to asset mix (including cash position) and expected portfolio characteristics.

- Changes in the Investment Manager's Firm: Discussion of any changes in the investment manager's firm including, but not limited to, professional turnover, ownership changes, investment strategy, and philosophy.
- Changes in the Fund's Requirements: Discussion of any required modifications to the investment program and strategy, including changes necessary to comply with new legislation or regulation.

Brokerage Direction Policy

All international equity managers may be asked to participate in a directed brokerage arrangement, if any such arrangement is approved and adopted by the Board, provided, however, that notwithstanding such participation, brokerage transactions in the normal course of business should only be directed on a best execution basis. In addition, brokerage transactions should not be directed if in doing so, taking all factors into consideration, the Fund will incur a disadvantage with respect to the market price of the security. Managers are free to seek the best execution of transactions through any broker dealer. However, Managers shall not execute transactions through its affiliate broker/dealer firm, if such affiliation exist, nor shall they involve an affiliate firm, directly or indirectly, in clearing and/or settling transactions. Managers will be advised on an individual basis as to the targeted percentage of trades that shall be executed under a directed brokerage arrangement, subject to best execution.

The use of soft dollars is prohibited for paying investment manager fees.

Proxy Voting

The Board requires that the investment managers shall exercise their authority with regard to proxy voting, acting solely in the best interest of and for providing benefits to participants and beneficiaries. Further, the Board requires that the investment managers will not subordinate the interest of participants and beneficiaries to unrelated objectives. The Board further requires that the investment managers exercise their authority with regard to proxy voting consistent with the guidelines relating to shareholder activism set forth in ERISA Reg. §2509.94-2(3), and such exercise shall be deemed consistent with the interest of participants and beneficiaries.

Exceptions

Each investment manager is required to comply with the objectives and guidelines set forth in this document. The Finance Committee requires that any exceptions taken to this Statement be submitted in writing to the Finance Committee for its written approval.

C. Domestic Fixed-Income Investment Manager

Introduction

The manager is granted full discretion to buy, sell, invest, and reinvest its portion of the Fund's assets in domestic fixed-income investments in a manner consistent with the policy and guidelines set forth in this document. Wherever these guidelines contain a limitation expressed as a percentage of the Fund or its accounts or portfolio, that percentage shall be measured solely with reference to the portion of the Fund's assets that are under the individual manager's control.

Investment Objectives

The investment objective of the fixed-income managers is to achieve consistent positive real returns and to maximize long-term total return within prudent levels of risk through a combination of income and capital appreciation. In accomplishing this objective, the manager shall adhere to the philosophy and style that was articulated to the Finance Committee at or subsequent to, the time the manager was hired. Any change in such philosophy and/or style must be communicated to the Finance Committee in writing at least sixty-days (60) in advance of the change.

Performance Objectives

Due to the inevitability of short-term market fluctuations that may cause variations in the investment performance, it is intended that the performance objectives outlined below will be achieved by the investment managers over full market cycles of three to five year periods. However, the Finance Committee reserves the right to evaluate and make any necessary changes regarding the investment managers over a shorter term. Quarterly performance will be evaluated to test progress toward attainment of longer-term goals. It is understood that there are likely to be short-term periods during which performance deviates from market indices. During such times, greater emphasis shall be placed on performance comparisons with managers employing similar styles. Minimum performance guidelines are as follows:

1. Achieve a net of fee rate of return, which exceeds the appropriate benchmark over a complete market cycle (generally 3-5 years).
2. Over a minimum 3-year period, achieve cumulative performance results that rank above the 50th percentile in a relevant style-group of similar investment managers, which group shall be determined by the Finance Committee.
3. Over a minimum 3-year period, achieve a positive risk/reward trade-off when compared to other managers in a relevant style-group, which group shall be determined by the Finance Committee.

Attainment of these objectives does not guarantee continued employment by the Fund nor does failure to achieve these guidelines insure dismissal. Managers serve at the discretion of the Finance Committee.

Pooled/Mutual Plan Exceptions

In the case of a commingled account or mutual fund, the Fund understands that strict adherence to the investment guidelines set forth below is impracticable. Accordingly, the Finance Committee waives such strict adherence, and the pooled/mutual plan's investment objectives, policies and restrictions, as set forth in its current prospectus and statement of additional information (as amended from time to time), shall govern the investment of the Fund's assets. The pooled/mutual fund shall also exercise prudent care in managing the portfolio.

Guidelines

The System must comply with investment restrictions imposed by the Government Development Bank for Puerto Rico Statements of Investment Guidelines for Public Retirement Plans and any other Commonwealth and federal laws dealing with investment of public retirement plan assets. All investment managers are expected to perform their fiduciary duties as prudent people would and to conform to all Commonwealth and Federal statutes governing the investment of retirement plans. Investments should primarily be in liquid, marketable securities. Separate account managers shall otherwise have full discretion, subject to the following guidelines:

- Securities managers shall be Banks or registered advisors under the Investment Advisors Act of 1940.
- The Fund's assets placed with the Manager shall not constitute more than 10% of total assets under its management, unless specifically approved by the Board.
- Unrated securities other than those issued by the U.S. government or its Agencies may not be purchased without the prior written consent of the Finance Committee. Approved exceptions are 144A Privates (non-registered debt issued by corporations), when such companies' registered debt carries an investment grade rating by either Moody's or Standard & Poor's, and are limited to 10% of the book value of the portfolio.
- Up to 15% of the portfolio may be invested in Non-U.S. Dollar denominated securities.
- Securities downgraded subsequent to purchase resulting in violation of quality guidelines must be sold as soon as the manager deems it prudent and practical.
- Managers may not hold more than 10% of the market value of the portfolios in any one issuer's securities other than direct or moral obligations of the U.S. Government.
- Managers may not hold more than 5% of the market value of the portfolios in any single debt issue other than direct or moral obligations of the U.S. Government.
- Up to 20% of the portfolio may be invested in Collaterized Mortgage Obligations (CMO's) backed by pools of mortgages guaranteed by the full faith and credit of the U.S. Government or an agency thereof, as well as non-agency

backed securities. These include Normal PAC bonds (including Z tranche), Normal sequential bonds, TAC bonds, Accrual bonds, and VADM's.

- Subject to other restrictions listed in this section, options will be permitted for hedging purposes to the extent that they are consistent with the overall investment guidelines and do not leverage the portfolio in any way. Derivatives with payments or values that are linked to indices or assets that are inconsistent with the overall investment guidelines are not permitted.
- At any time, the portfolio must have an overall weighted average credit rating of "AA" or better by Standard & Poor's or Moody's (AA2) rating services. In the case of split ratings, the higher rating shall prevail.
- High-risk mortgage securities, as defined in Addendum II, are prohibited. High-risk mortgage securities must be subjected to the FFIEC High Risk Mortgage Security Test.
- The following instruments are acceptable:
    - Commercial Paper of Variable Rate Notes of P-1 or equivalent rating. In addition, bank certificates of deposit must be of institutions rated among one of the top 3 rating categories by Bank Watch (A, A/B, or B-)
    - Certificates of Deposit and Bankers Acceptances rated Baa or better by Moody's Investors Service or Standard & Poor's.
    - United States Treasury Bonds, Notes, and Bills.
    - Repurchase agreements with U.S. Treasury Securities and agencies of the U.S. Government as collateral.
    - Debt instruments of the U.S. Government or its Agencies and Instrumentalities.
    - Minimum credit quality for all fixed-income securities shall be BBB- (Standard & Poor's) or Baa3 (Moody's), or of comparable quality. In determining the quality rate of an issue, the higher of the major agencies or comparable rating will apply.
- The portfolio as a whole should be managed consistent with the original mandate under which the manager was hired, and as set forth on the manager's sign-off page. No extreme position should be taken which would alter the character of the portfolio that could produce results inconsistent with that mandate.

Communication and Reporting Requirements

Investment managers shall inform the Finance Committee of any changes in the quality ratings of securities in the Fund, which may cause such securities to fall below the quality standards stated herein. Such communication will be immediate, verbal and in writing to the Finance Committee. In addition, investment managers shall maintain on-going communication with the Consultant in order to allow for proper execution of due diligence responsibilities and shall communicate any matters deemed relevant to the well-being of the Fund to the Consultant ant the Finance Committee in a timely matter.

Investment managers are required to provide a monthly performance report detailing all transactions and cash flows for the period to the System's Staff. In addition, the investment managers are required to provide quarterly reports to the Staff and Finance Committee. The quarterly reports must include the following:

- Reconciliation of Market Value, on a monthly basis with a summary of all discrepancies with the Custodian that have been outstanding more than 90 days.
- Performance Results for the most recent quarter, fiscal YTD, calendar YTD, year, three-year period, five-year period, seven-year period and since inception.
- Notice of any material changes in organizational structure, ownership, key personnel, strategy, or philosophy of the firm.
- Any material litigation pending against the firm or any of it's' members whether criminal, civil, or administrative.
- Certification that the portfolio is being managed in accordance with investment guidelines stated herein.

On an annual basis, the reports should include the annual filing of Form ADV with the Securities and Exchange Commission.

Investment managers must meet with the Finance Committee as required. The Finance Committee expects to receive a written summary that responds to the subjects identified in the following agenda at least seven days prior to any such meeting. These meetings will also provide the investment managers with the opportunity to explain how their investment strategy/outlook has evolved since previous meetings.

The agenda will include the following:

- Performance for Past Period: Standard time periods for each report will be Last Quarter, Fiscal, and Calendar Year to Date, Last Year, 3 Years, 5 Years, 7 Years, and Since Inception. Returns should be annualized and calculated on a time-weighted basis for the total portfolio. All returns should include income and dividends and be footnoted as to whether they are gross or net of fees. Returns should also be measured against the appropriate benchmark.
- Rationale for Performance Results: Discussion of the rationale for performance results, relating them specifically to investment strategy and tactical decisions implemented during the current review period.
- Specific Near-Term Strategy: Discussion of the investment manager's specific strategy for the portfolio over the near-term period, with specific reference to asset mix (including cash position) and expected portfolio characteristics.
- Changes in the Investment Manager's Firm: Discussion of any changes in the investment manager's firm including, but not limited to, professional turnover, ownership changes, investment strategy, and philosophy.

- Changes in the Fund's Requirements: Discussion of any required modifications to the investment program and strategy, including changes necessary to comply with new legislation or regulation.

Exceptions

Each investment manager is required to comply with the objectives and guidelines set forth in this document. The Finance Committee requires that any exceptions taken to this Statement be submitted in writing to the Committee for its written approval.

D. Real Estate Investment Managers

Introduction

The real estate manager is granted full discretion to buy, sell, invest, and reinvest its portion of the Fund's assets in real estate investments in a manner consistent with the policy and guidelines set forth in this document. Wherever these guidelines contain a limitation expressed as a percentage of the Fund or its accounts or portfolio, that percentage shall be measured solely with reference to the portion of the Fund's assets that are under the individual manager's control.

Investment Objectives

The investment objective of the real estate managers is to achieve consistent positive real returns and to maximize long-term total return within prudent levels of risk through a combination of income and capital appreciation. In accomplishing this objective, the manager shall adhere to the philosophy and style that was articulated to the Finance Committee at or subsequent to, the time the manager was hired. Any change in such philosophy and/or style must be communicated to the Finance Committee in writing at least sixty-days (60) in advance of the change.

Performance Objectives

Due to the inevitability of short-term market fluctuations that may cause variations in the investment performance, it is intended that the performance objectives outlined below will be achieved by the investment managers over full market cycles of three to five year periods. However, the Finance Committee reserves the right to evaluate and make any necessary changes regarding the investment managers over a shorter term. Quarterly performance will be evaluated to test progress toward attainment of these longer-term goals. It is understood that there are likely to be short-term periods during which performance deviates from market indices. During such times, greater emphasis shall be placed on performance comparisons with managers employing similar styles. Minimum performance guidelines are as follows:

1. Achieve a net of fee rate of return that exceeds the appropriate benchmark over a complete market cycle (generally 3-5 years).
2. Achieve a minimum of 5% total real rate of return (net of investment manager fees) over rolling 5-year periods. The CPI-All Urban inflation index will be used to calculate the real rate of return.
3. Over a minimum 3-year period, achieve cumulative performance results, which rank above the 50th percentile in a relevant style group of similar investment managers, which group shall be determined by the Finance Committee.
4. Over a minimum 3-year period, achieve a positive risk/reward trade-off when compared to other managers in a relevant style-group, which group shall be determined by the Finance Committee.

Attainment of these objectives does not guarantee continued employment by the Fund nor does failure to achieve these guidelines ensure dismissal. Managers serve at the discretion of the Finance Committee.

Pooled/Mutual Plan Exceptions

In the case of a commingled account or mutual fund, the Fund understands that strict adherence to the investment guidelines set forth below is impracticable. Accordingly, the Finance Committee waives such strict adherence, and the pooled/mutual plan's investment objectives, policies and restrictions, as set forth in its current prospectus and statement of additional information (as amended from time to time), shall govern the investment of the Fund's assets. The pooled/mutual fund shall also exercise prudent care in managing the portfolio.

Guidelines

The System must comply with investment restrictions imposed by the Government Development Bank for Puerto Rico Statements of Investment Guidelines for Public Retirement Plans and any other Commonwealth and federal laws dealing with investment of public retirement plan assets. All investment managers are expected to perform their fiduciary duties as prudent people would and to conform to all Commonwealth and Federal statutes governing the investment of retirement plans. Separate account managers shall otherwise have full discretion, subject to the following guidelines:

- Managers shall be Banks or registered advisors under the Investment Advisors Act of 1940.
- The Fund's assets placed with the Manager shall not constitute more than 10% of total assets under its management, unless specifically approved by the Board.
- The Investment Manager shall retain individuals possessing appropriate property management expertise, including independent appraisers.
- All assets must be of institutional investment quality as evidenced by a precedent of institutional investment in similar properties; expert analysis which supports the economic viability of the market; high quality construction and design features; and a current or potentially competitive position within the property's immediate market area.
- The real estate portfolio shall be diversified by geographic region and property type.
- No more than 20% of "Committed Funds" of a commingled fund or a separate account may be invested in any one property or investment. "Committed Funds," means the aggregate of all funds committed to the investment by all investors in a commingled fund or by the Fund in a separate account and shall not include any non-recourse debt used to acquire, refinance, or improve portfolio property.
- No single participation in a limited partnership will have an average maturity exceeding 7 years.
- Leverage may be used in a constrained manner in order to enhance yields in various investments and/or facilitate the diversification of the portfolio. The total level of debt for the total portfolio will be limited to thirty percent (30%).

Additionally, leverage will be limited to "positive leverage" where cash flow is in excess of debt service.

- Leverage is limited to non-recourse debt secured solely by the property acquired, refinanced, or improved with such debt. Recourse debt used to acquire, refinance, or improve portfolio property secured by other assets or funds of a commingled fund or separate account may not be utilized.

Communication and Reporting Requirements

Investment managers shall maintain on-going communication with the Consultant in order to allow for proper execution of due diligence responsibilities. In addition, investment managers shall communicate any matters deemed relevant to the well-being of the Fund to the Consultant ant the Finance Committee in a timely matter.

Investment managers are required to provide quarterly reports to the Committee. Reports must include the following:

- Performance Results for the most recent quarter, fiscal YTD, calendar YTD, year, three-year period, five-year period, seven-year period and since inception.
- Notice of any material changes in organizational structure, ownership, key personnel, strategy, or philosophy of the firm.
- Any material litigation pending against the firm or any of it's' members whether criminal, civil, or administrative.
- Certification that the portfolio is being managed in accordance with investment guidelines stated herein.

Investment managers must meet with the Finance Committee as required. The Finance Committee expects to receive a written summary that responds to the subjects identified in the following agenda at least seven days prior to any such meeting. These meetings will also provide the investment managers with the opportunity to explain how their investment strategy/outlook has evolved since previous meetings.

The agenda will include the following:

- Performance for Past Period: Standard time periods for each report will be Last Quarter, Fiscal, and Calendar Year to Date, Last Year, 3 Years, 5 Years, 7 Years, and Since Inception. Returns should be annualized and calculated on a time-weighted basis for the total portfolio. All returns should include income and dividends and be footnoted as to whether they are gross or net of fees. Returns should also be measured against the appropriate benchmark.
- Rationale for Performance Results: Discussion of the rationale for performance results, relating them specifically to investment strategy and tactical decisions implemented during the current review period.
- Specific Near-Term Strategy: Discussion of the investment manager's specific strategy for the portfolio over the near-term period, with specific reference to asset mix (including cash position) and expected portfolio characteristics.

- Changes in the Investment Manager's Firm: Discussion of any changes in the investment manager's firm including, but not limited to, professional turnover, ownership changes, investment strategy, and philosophy.
- Changes in the Fund's Requirements: Discussion of any required modifications to the investment program and strategy, including changes necessary to comply with new legislation or regulation.

Exceptions

Each investment manager is required to comply with the objectives and guidelines set forth in this document. The Finance Committee requires that any exceptions taken to this Statement be submitted in writing to the Finance Committee for its written approval.