LEE MEMORIAL HEALTH SYSTEM BOARD OF DIRECTORS

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PURPOSE:

Establish an investment management policy and process for reviewing the management and custodianship of the Health System's investments of assets. This policy shall not apply to the investment of funds in employee retirement programs.

POLICY:

I. General Principles

This document is intended to set forth the long-term objectives of the Lee Memorial Health System Board of Directors d.b.a. Lee Memorial Health System (the System) ~~Non-ERISA~~ investment program and the guidelines to be followed in attempting to meet those long-term objectives. It covers all investment funds whether currently existent or established in the future and is intended to be sufficiently specific to be meaningful, but sufficiently flexible to be practical. Funds governed shall be those in excess of that required to meet current expenses, debt service and capital expenditures. This policy shall not apply to the investment of funds in employee retirement programs.

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A. Statement of General Investment Objective

The long-term objective of the System's investment portfolios is to generate a return, which is sufficient to meet its current and expected future financial requirements. To accomplish this objective, the System seeks to earn the greatest total return possible consistent with its general risk tolerance, the securities noted as eligible for purchase, and the permissible investment strategies as outlined in this Policy. At all times, funds shall be invested with safety of capital, liquidity of funds and income as primary priorities.

B. Statement of General Risk Tolerance

The various Funds, which comprise the investment program, will be structured in a manner that most efficiently matches the Funds' investment risk and return characteristics with their long-term purposes and objectives. Short-term volatility and uncertainty of investment results are recognized as real, but not overriding risks, and will be managed appropriately through specific asset allocation strategies and diversification based upon the portfolios' investment time horizon and the fiduciaries stated risk limits**.**

Consistent with this view, the portfolios will be evaluated on a "total return", rather than on a "yield" basis and the total return earned shall be particularly measured against risk taken by the computation of a Sharpe ratio.

At all times, investments should be made with the judgement and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of capital as well as the probable income to be derived from the investment.

II. Specific Investment Objectives

<u>The System</u>

Lee Memorial Health System, a special unit of local government, is a dominant healthcare provider in Southwest Florida. The risk analysis and financial plan associated with this policy indicates that the System has as a goal, the overall financial profile associated with an A+ credit rating.

The Risk and Return objectives of the System's investment portfolio have been quantified using inputs supplied by management and outside sources. In developing the risk and return objectives, management has developed return targets, which are expected to:

a) Provide a cushion against erratic operating performance;

b) Fund ongoing cash flow requirements;

c) Fund strategic initiatives and new ventures;

d) Fund ongoing capital expenditures;

e) Provide financial flexibility necessary to meet unforeseen capital requirements;

f) Fund mission obligations which do not produce a financial return;

g) Provide credit stability;

h) Fund additions to working capital; while

i) Complying with established risk tolerances, and utilizing only acceptable securities.

A. Rate of Return.

The minimum return on capital, which satisfies the objectives above over the next five years as of 02/2001, is projected to be 6.10%. The investment portfolio shall earn as high of a return possible while complying with Section B., and minimizing the possibilities of earning less than the calculated minimum of 6.10% as annualized over the investment horizon.

B. Risk.

The Board has completed its annual Risk Profile update as of 09/30/99. Consistent with this update, they have established a Value at Risk limit of (10.80%). This VAR assumes the following:

- 95% confidence interval
- One-year holding period
- No change in holdings

This Value at Risk shall be calculated as of the end of each calendar quarter and it is expected that the calculated VAR shall not substantially exceed or fall short of this limit.

C. Investment Horizon.

The horizon is representative of the System’s financial life and has been calculated by Highland Associates to be 16 years. This horizon shall be used for risk analysis, volatility sensitivity and target return calculations.

D. Primary Reserve Requirements.

Over the Horizon, the market value of investments under this Policy section should not fall below the sum of: (a) the System’s variable rate debt outstanding and (b) 90 days of cash requirements for the System’s operations.

E. Operating Standards

The Board has adopted an overall, long-term goal as that of maintaining a financial profile equivalent to the financial ratios associated with the median hospital with a **bond rating of A+.** These standards are used to calculate the minimum return referenced in Section A., and are shown below for this policy update period.

	Target/Ratio
Average Age of Plant (years)	9.18
Cushion Ratio	13.5x
LTD/Net Fixed Assets	84%
LTD/Capitalization	39.2%
Debt/Cash Flow	3.85%
Debt Service Coverage	3.50x

F. Changing Conditions and Specific Review Requirements

This Policy shall be reviewed on at least an annual basis as part of an updated risk profile analysis. The documentation shall include a review of internal controls sufficient for documentation of any financial audit required by the Board. The Policy shall be immediately reviewed upon the occurrence of any of the following events in order to determine if the established risk level is still acceptable:

1) The Entity re-finances or re-capitalizes any material portion of its debt.
2) The variable interest rate on outstanding debt increases by more than 30% over any annual period.
3) The Entity experiences a loss from operations for **5** out of any six-month period.

III. Responsibilities and Authorities

A. Board of Directors

The Board of Directors has the ultimate fiduciary responsibility for the prudent and effective investment of the System's assets. The Board of Directors shall establish an Investment Policy for the System, which provides guidance on the investment of portfolio assets for itself and all other governing or managerial bodies which assist the Board of Directors in meeting its fiduciary responsibility by assuming stewardship responsibilities for these assets.

B. Management

Management shall perform the following activities:

1) Develop sound and consistent portfolio objectives and Investment Policy guidelines for approval by the Board;
2) Review the Investment Policy annually and recommend modifications to the Board;
3) Select and recommend for Board approval a qualified investment advisor, investment fund managers, and custodians based upon the criteria outlined in Section IV.
4) Communicate fully, in writing, the major duties and responsibilities of the System's investment advisors, custodians and investment fund managers;

5) Monitor and evaluate performance results quarterly and annually to assure that policy guidelines are adhered to and objectives are met;

6) Take appropriate actions to replace investment fund managers, custodians and investment advisors for failure to perform as mutually expected;

7) Formulate, in concert with the investment advisor, the investment strategy and related asset allocation and risk allocation recommendations; and

8) Perform ongoing day to day supervision of the investment fund managers, custodian banks and investment advisors.

C. Investment Advisor

The Board of Directors will select an investment advisor to provide additional expertise in formulating investment strategies, developing the Investment Policy, recommending investment fund managers and reviewing the performance of those investment fund managers, and evaluating the overall performance of the System's portfolio. Selection of the investment advisor will be based upon criteria established by Management and approved by the Board of Directors, which recognizes the importance of significant investment experience with organizations similar to the System. Prior to selection, it shall be determined that the investment advisor qualifies under the criteria outlined in Section IV-A of this Policy.

D. Investment Fund Managers

The Board of Directors will select one or more investment fund managers, registered with the Securities and Exchange Commission under the Investment Advisors Act of 1940 as Registered Investment Advisors. The Board of Directors grants the investment fund managers the authority to purchase and sell securities at the managers' discretion, as long as the investment decisions are made in conformity with the investment objectives and guidelines as outlined in the Investment Policy and the Investment Fund Manager Directives. Prior to selection, it shall be determined that each investment fund manager qualifies under the criteria outlined in Section IV-B of this Policy.

E. Custodians

The Board of Directors shall select a custodian to hold and account for the investment assets of the System. Such custodians shall qualify under criteria stipulated in Section IV-C of this Policy.

F. Conflicts of Interest

The following parties shall fall under the Conflicts of Interest provision of this Investment Policy: All persons who are appointed to serve on any Boards of Directors, or who are in positions of governance or positions from which they can affect the policy of any Affiliate, which is related to or governed by the System. Also, all persons who sit on the Board of Directors, or any persons who have direct fiscal participation in, or perform in an executive capacity with influence over Management or performance of any organization mentioned above.

These persons and institutions described above are precluded from serving as investment advisors; acting as investment fund managers; or providing significant brokerage services.

Local banking institutions or independent trust companies, which have an employee or significant shareholder who falls under these provisions, are not precluded from holding or managing the System or its Affiliates' portfolio assets as long as their interest rates, fees, expenses and services are competitive; the level of participation is not deemed significant and there is no loss or harm which can accrue to the System or any of its Affiliates from such a relationship.

Notwithstanding the aforementioned, financial services can be provided by a national firm which employs any person who meets the criteria listed above, to the extent that the individual meeting the criteria is not directly involved with a transaction between the System or any of its Affiliates and the individual's employer, and the individual does not stand to benefit directly or indirectly from such a transaction.

The System's investment advisor may not have any undisclosed direct or indirect financial relationship, or provide any services to any investment fund manager who provides services to the System. No broker/dealer or brokerage firm associated with the investment advisors may handle any transactions for the System, unless those transactions are performed as a conduit through which the System is able to recapture a significant portion of their trading costs. Significant means that at least 50% of the costs of any trades handled by the related broker/dealer must be captured for the exclusive benefit of the System.

G. Compliance with Law

All actions undertaken or contemplated by this Policy shall follow appropriate law. Included under this requirement is that all activities shall be deemed appropriate within the relevant sections of the Internal Revenue Code dealing with arbitrage and other applicable tax requirements for 501(c)(3) organizations. The investment portfolio of the System is governed by Section 16 of chapter 63-1552, Laws of Florida, as amended.

IV. Provider Eligibility Requirements

The criteria which follows shall be applied to the selection of Investment Advisors, Investment Managers, and Custodians for the System's Funds. The Board, in its sole discretion, may select a party for any of these roles that does not qualify under these criteria. However, they should document their rationale for doing so.

A. Investment Advisor

An investment advisor may be retained to assist the Board of Directors and various Committees, which may from time to time be established by the Board and Management with the investment of the various portfolio assets. For an investment advisor to be considered, the prospective firm must meet the following criteria upon retention:

1. Be a completely independent and objective, fee-paid advisor (i.e. the firm can not be an investment manager or manage any investments directly);
2. Have a minimum of 5 years verifiable consulting experience;
3. Have significant experience in advising on both pension and non-pension investment portfolios of healthcare organizations and healthcare systems;

4. Demonstrated stability of both personnel and client relationships;
5. Neither the investment advisory firm being considered nor the individual consultant recommended to the Board, may have had any significant litigation that has relevance to their honesty, integrity or abilities; and
6. Be able to provide full-line investment advisory services including:
    a) Development of Investment Policy
    b) Development of Asset Allocation and Risk Allocation Strategy
    c) Custodian/Trustee Search and Contract & Fee Negotiation
    d) Manager Search and Contract & Fee Negotiation
    e) Performance Measurement & Evaluation
7. All prospective investment advisors should exhibit the following characteristics:
    a) Substantial resources;
    b) Stable support services;
    c) Exhibited control over growth;
    d) Quality personnel in research, management and communications; and
    e) Reasonable number of accounts and assets gained and lost over the review period.
8. Investment advisors shall be subject to regular review utilizing the Investment Advisor criteria attached to this policy. Investment advisor performance shall be evaluated by the System's Board of Directors and Management.

B. Investment Fund Managers

Professional investment fund managers may be retained to conduct the day to day management of the System's portfolio if their retention results in an improvement of the risk/return characteristics of the portfolio. These managers will be allowed to purchase on behalf of the System only the eligible securities described in Section VI of this Policy.

If multiple investment fund managers are utilized, the objective shall be to optimize efficiency through diversification among managers of varying styles such that the total portfolio diversification is maximized, total portfolio efficiency is enhanced, and risk adjusted returns are maximized at the stated VAR limits.

For an investment fund manager to be considered, the prospective firm must meet the following criteria upon retention:

1. Registered with the Securities and Exchange Commission under the Investment Advisors Act of 1940 as a Registered Investment Advisor or specifically exempted from such registration.

2. A minimum of $**500** million under management or an amount deemed appropriate for the particular investment strategy under consideration;

3. Managers must have a sound investment philosophy & investment process.

4. A minimum of **10** years of verifiable or audited performance results. These performance results should include all accounts of similar style managed by the firm, equally weighted, regardless of size. There should be no “survivorship bias” and Model, Backtested and Hypothetical portfolios are not acceptable.

5. The record submitted must have been produced by the investment professionals following the same discipline as represented to the System, for at least three years;

6. Historical performance shall exceed the performance of **66%** of investment fund managers of similar styles for the period under review;

7. Managers must have exhibited good performance relative to managers of similar disciplines during complete market cycles;

8. Investment fund managers must have shown an ability to seek competitive commission rates;

9. Neither the investment fund management firm being considered nor the individual manager recommended to the System may have had any significant litigation that has relevance to their honesty, integrity or abilities;

10. Firms considered must have shown stability of both personnel and accounts; and

11. Firms must demonstrate: substantial resources to ensure future viability sufficiently staffed back offices and quality of personnel in research, management and communications.

Upon retention, each investment fund manager will be provided with a copy of this Investment Policy as well as a written set of Investment Fund Manager Directives which will specifically outline the System’s expectations for that firm including performance objectives and quality standards. Investment manager’s performance shall be regularly evaluated versus these objectives and quality standards by the System’s management and investment advisor

Any investment fund manager considered by the Board of Directors shall comply with a due diligence review intended to confirm the quality criteria outlined in this Investment Policy and the Investment Fund Manager Directives, and be willing, if asked, to verify in writing that the firm meets these criteria. When professional investment fund managers are retained, they shall have complete discretion over the investment of their portion of the account assets as long as their actions remain consistent with both their investment style and other factors stipulated in their Investment Fund Manager Directives and by this Investment Policy. The distribution of assets to be managed by investment fund managers will be periodically adjusted to maintain the general required asset allocation and risk profile determined as appropriate for the System. Investment fund managers may be terminated for a number of reasons, which will be outlined in the Investment Fund Manager Directives.

Managers may be terminated if:

a) A change in the System’s requirements results in the Firm’s investment style being inconsistent with portfolio objectives;

b) The manager changes their investment style;

c) Fundamental quality or conditions within the firm change; or

d) The manager violates specific directives issued to him.

The Manager shall also be subject to an annual evaluation documented as attached to this Policy.

C. Custodian

In order to effectively and efficiently implement the investment program, the System will retain a custodian for security safekeeping and transaction reporting. The System may not use a brokerage firm for this purpose. In order to be selected by the System, a custodian must meet the following criteria:

1. The financial institution selected should have the financial resources and commitment necessary to continue to allocate the capital sufficient to maintain and upgrade custodian capabilities to "state of the art" levels. Senior long-term debt must be of investment grade.

2. The institution should be able to present a history of client satisfaction through a quality review and audit program.

3. The organization shall comply with a complete due diligence study in order to confirm items 1 and 2 above.

4. Any institution selected to serve as the System's custodian should also meet the following qualifications:

   a) Hold at least $40 Billion of assets in custody;

   b) Possess Master Trust/Master Custody accounting capabilities or some form of share accounting;

   c) Provide full accruals on a trade date accounting basis;

   d) Have a full cash management and accounting capability;

   e) Produce executive, management, and audit level reports on an inquiry, routine and custom basis;

   f) Offer fully collateralized securities lending with effective queuing process as outlined in Section V of this policy; and

   g) Remain in compliance with these criteria supported by the assurance provided through ongoing monitoring by the System's Management and Investment Advisors.

The custodians selected shall hold all securities of the System in a segregated account separate from other accounts.

5. The Custodian shall be subject to regular review utilizing the Custodian criteria attached to this policy. Custodian performance shall be evaluated by the System's Management and Investment Advisor.

V. Securities Lending

The System may participate in security lending programs if the custodian providing the program meets the criteria above and the following additional criteria;

1. Program must average $**7** Billion in loaned securities on a daily basis;
2. Loans are collateralized by cash or government securities equal to at least 102% of the market value of the loaned securities;
3. Collateral is marked to market and adjusted on a daily basis;
4. Participating brokers must pass stringent credit review criteria which are established by the custodian and are reviewed on a regular basis;
5. Information and reporting systems fully support the lending activity; and
6. Cash collateral is invested and controlled by an investment policy allowing securities similar to those in Section VI-A.

VI. Eligible Asset Classes & Securities

As a fiduciary body, the Board of Directors has taken steps to ensure that the investment risks assumed by all assets over which they have stewardship are reasonable and prudently managed. The System's assets may be segregated into several different funds at the custodian level based upon their purpose and objective.

The asset allocation strategies will be implemented by investing in one or more of the asset class pools listed below.

A. Cash Pool
B. Fixed Income Pool
C. Equity Pool
D. Alternative Investment Strategies

Each pool will comprise a specific asset class or in the case of "Alternatives" a particular portfolio strategy. The specific securities that will be eligible for purchase within each pool are outlined below. Additional pools (asset classes) may be approved in writing by the Board of Directors from time to time, in keeping with the overall objective of this Investment Policy and specific enabling legislation.

A. Cash Pool

The Cash Pool is designed to provide the System with a competitive current return and a high level of liquidity and it is in this pool that investment maturity shall be matched to anticipated cash flow requirements. The aggregate duration of the portfolio shall not exceed one and one-half years.

Security	**Maximum Maturity**
Treasury Bills, Notes & Bonds	3 years

Agency Notes & Bonds	3 years
Repurchase Agreements	3 years
Bank Certificates of Deposit	3 years
Bankers Acceptances	3 years
Commercial Paper (P2 or better)	3 years
Domestic Corporate Notes & Bonds (BBB or better by 1 of 2 major rating agencies)	3 years
Asset-Backed Securities except those backed by LBO loan participations	3 years
Eurodollar C.D.'s and Time Deposits	3 years
Investment Grade Yankee Bonds (BBB or better)	3 years
Collateralized Mortgage Obligations (AA or better)	3 years

B. Fixed Income Pool

The aggregate duration of the Fixed Income Pool shall not exceed that of the Lehman Brothers Aggregate Bond Index by +\- 25%.

Security	Maximum Maturity
Treasury Bills, Notes & Bonds	No Limit
Agency Notes & Bonds	No Limit
Repurchase Agreements	No Limit
Bank Certificates of Deposit	No Limit
Bankers Acceptances	No Limit
Commercial Paper (P2 or better)	No Limit
Domestic Corporate Notes & Bonds (BBB or better by 1 of 2 major rating agencies)	No Limit
Asset-Backed Securities except those backed by LBO loan participations	No Limit
Eurodollar C.D.'s and Time Deposits	No Limit
Investment Grade Yankee Bonds (BBB or better)	No Limit
Collateralized Mortgage Obligations	No Limit
(AA or better)	No Limit
Non-Dollar Sovereign Notes and Bonds	No Limit
Non-Dollar Investment Grade, Notes and Bonds	No Limit

C. Equity Pool

Securities purchased in the equity pool shall be dollar denominated or non-dollar denominated publicly traded on a national exchange.

D. Alternative Investment Strategies

This pool shall be composed of interests held in Alternative Investments. Qualifying strategies shall be limited to traditional long/short strategies and/or market neutral strategies.

This pool shall contain strategies or combinations of securities, invested to achieve a particular end, and/or to achieve a distribution of returns not otherwise expected. In this case, qualifying strategies shall be those utilizing only securities otherwise eligible for purchase under these guidelines and enabling state legislation. In addition strategies held in this pool must meet the additional restrictions noted in Section G. The purpose of segregated strategies in a specific pool is to focus the measurement efforts and particular oversight.

E. Securities to Watch

Securities which are not prohibited by the Board of Directors, but which must be analyzed and accepted by the Board of Directors before use include:

1. The use of Options and Futures as a hedge; and
2. Derivative securities upon specific approval in advance, and meeting criteria established for derivatives.

F. Derivatives

1. No manager shall purchase a security whose value is derived from a different asset class or security type, and whose basic structure could change fundamentally due to market movement in the asset class or security type from which the security's characteristics are derived.
2. Managers may not create leverage within the portfolio through the use of securities, which have been purchased but not yet paid for or delivered, or in any other form. At no time shall a manager purchase securities, which would create an obligation greater than the amount of assets available to pay for such securities. Managers may not speculate through the use of Options and Futures, but may employ these securities as a means of reducing cost or reducing risk.
3. Collateralized Mortgage Obligations (CMOs) and Structured Notes - CMOs and Structured Notes shall not be purchased by managers unless the risks have been adequately measured and understood with respect to both the individual security and its impact on the risk of the entire portfolio. Specific risks include, but are not limited to: duration, convexity, yield curve, prepayment, liquidity, credit and counterparty risk. Securities should also be "stress - tested" to determine the effects of changing prepayments, interest rate levels, yield curve shape, and volatility in projecting prices. Additionally, the portfolio's risk should measured in terms of absolute risk (the probability of incurring a negative return) and relative risk (the probability of under or outperforming the appropriate benchmark).
4. Managers given permission to own derivative securities must be willing to answer a risk questionnaire on a regular and timely basis in order to document their competence and through the analysis of such questionnaires, System management should gain sufficient understanding of the strategy prior to its use being approved.
5. Options and futures contracts may be used by investment fund managers who have demonstrated an ability to add value with these securities within an acceptable level of risk may purchase these securities with the specific written approval of

Management and the Board of Directors. This provision shall include the use of covered calls.

G. Limitations

The investment portfolio of the System is governed by the System's Enabling Legislation. Provided below is a summary of the law's limitations on investments. The system's assets shall be invested according to the specifics of the law (attached as exhibit A), not the following summary.

(1) NO LIMITATION

(a) U.S. Bonds, notes or obligations

(b) State bonds (including Revenue bonds)

(c) County or District Bonds

(d) Savings accounts, or CDs, Federally insured, not exceeding 15% of institutions net worth

(e) Federal Farm Credit or FHLB obligations

(f) Obligations of FHLMC

(g) Obligations guaranteed by GNMA

(h) Commercial Paper of prime quality (A1/P1 by at least one agency)

(i) Banker's Acceptances (by member of Fed with $400 million in deposits)

(j) Short term obligations, individual or pooled, for liquidity purposes

(k) Commingled vehicles investing in Treasuries and repos

(2) NO MORE THAN 25% OF FUNDS IN

(a) State municipals, rated in highest 3 tiers (by 2 agencies)

(b) Mortgages on Florida property guaranteed by FHA or VA

(c) Mortgage pass-through certificates, when

1. Property is located in state
2. Mortgages are originated by banks or S&L's operating in state
3. Mortgages are transferred or assigned to a corporate trustee

(d) Obligations of FNMA

(e) Group annuity contracts (limited to 3% with any one insurer)

(f) Mortgages (or funds) with equity, income or equity conversions

1. Title shall be vested in name of respective fund
2. For taxation, Florida statutes do not apply
3. Real property acquired, is not considered public land

(g) Foreign Government Obligations (without default for previous 25 years)

(h) U.S. Agency obligations authorized for the Florida Retirement System

(i) Yankee Bonds

(3) NO MORE THAN 50% OF FUNDS IN COMMON STOCK, PREFERRED STOCK OR CONVERTIBLES, Provided

(a) Company is organized in the U.S.

(b) Corporation is listed on a national exchange

(c) No more than 10% of the equity assets may be in issues of any one corporation

(d) No more than 3% of the equity assets may be in the issues of any one corporation, unless;

1. The issue is represented in a higher percentage of the S&P 500
2. Upon specific finding by the board, that a higher percentage is in the best interest of the board

(e) Options may be sold only to reduce investment risk, improve cash flow, or to provide alternative means for the purchase or sale of a security. Reversing transactions may be made to close existing positions

(4) NO MORE THAN 80% OF THE FUNDS SHALL BE IN CORPORATE BONDS

For purposes of determining the above percentages, bonds shall be valued at par, while equity and convertibles shall be valued at cost. Investments may be under repurchase and reverse repurchase agreements. Investments may be made to maximize financial return, while preserving appropriate diversification. The board may buy and sell futures and options, provided they are exchange traded. The board is authorized to invest in domestic or foreign national principal contracts.

Additionally, the Board of Directors has added the following limitations:

1. Mutual funds, unit and collective trusts, and bank and insurance company commingled accounts holding eligible securities are acceptable if there is a demonstrated advantage gained from such funds, and costs meet policy standards.

2. No corporate fixed income issue shall represent more than **5** % of any portfolio at the time of purchase, nor shall any single corporate position exceed **10%**. Equity issues when purchased shall represent no more than 3% of the portfolio (of any one issuer) and shall not grow to exceed 10%.

3. In no event shall the Entity purchase, or have purchased on their behalf, equity or debt securities issued by hospital management companies or related real estate investment trusts.

4. No more than 25% of the fixed income pool shall be non-dollar denominated.

5. No more than 50% of the total assets may be equity investments, no more than half of these equity securities may be non-dollar denominated.

6. Alternative investment strategies may be utilized if the strategy utilizes securities otherwise eligible for purchase under this policy and the following additional conditions are met.

    a. If a counterparty is required to effect the strategy in question, said counterparty shall have a credit rating of A. or better and if rated A. shall be required to post collateral.

    b. All securities and strategies shall be mappable into the VAR system.

    c. All securities shall be liquid and shall not typically have wide bid-asked spreads.

    d. Any leverage to be utilized shall be specifically acknowledged as part of the strategy and mappable into the VAR system.

    e. If specific managers are utilized as part of the strategy, they shall have:

        1. a top rank among peers

        2. a high Sharpe ratio

        3. stable organizational characteristics and a superior documented track record

    f. The following strategies shall be excluded from consideration:

        1. "macro" funds

        2. directional funds

        3. emerging markets only

        4. commodity pools

        5. high leverage funds

        6. "short only" funds

    g. All strategies shall be transparent as to positions held and risk exposures.

H. Special Funds

From time to time the System may hold funds in a special account to be used for a designated purpose such as a construction fund. In these instances, eligible securities shall be limited to those specified in the borrowing documents and/or credit enhancement.

The maturity of such holdings shall be such that liquidity requirements can be met without undue market risk.

VII. Asset Allocation

The Board of Directors recognizes that an investment portfolio's asset allocation strategy is the primary determinant of the portfolio's risk and return characteristics and that the level of risk accepted drives expected return. The asset allocation shall be that which is expected to earn maximum returns at the risk limited established by the Board as an allowable Value at Risk.

Management and its investment advisor will prepare asset allocation recommendations and strategy recommendations for Board approval based upon efficient allocation of the system's Value at Risk limits.

For this Policy Year, the Board of Directors has adopted the following asset allocation target:

Asset Class	Target
Cash Pool	15%
Fixed Income Pool	35%
Equity Pool	25%
Alternative Pool	25%

This asset allocation may vary as risk exposures are adjusted to remain within the System's VAR limit of (10.80%). This risk shall be allocated with the expectation that the portfolio Sharpe Ratio should exceed .55. The first policy objective is to comply with the VAR. Asset allocation is intended to maximize the return earned per stipulated VAR. Therefore, the asset allocation may vary somewhat from the target above. In no event shall allocations exceed the limits in the enabling legislation.

A. Re-balancing Guidelines

The Value at Risk of the portfolio shall be measured on a quarterly basis and the portfolio shall be re-balanced at that time as may be reasonably necessary to stay within the policy VAR limits of (10.80%).

VIII. Performance Monitoring, Evaluation and Reporting

Although the Board of Directors is primarily concerned with the long-term performance of the investment portfolios, it recognizes that the long-term performance is comprised of numerous shorter periods in which investment performance can be measured. Consequently, on a **monthly** basis, the investment advisor and the custodian will provide Management with sufficient information to assess investment performance on each of the various investment fund portfolios. On a **quarterly** basis, a written report that contains a review of the investment performance of each of the portfolios' investment fund managers, the specific Funds and the Affiliate assets as well as a qualitative and quantitative analysis of the portfolios' structures and contents will be prepared by Management and its investment advisor. This quarterly report shall include a VAR analysis and a comparison of risk/return efficiency and any necessary re-balancing. The **year-end quarterly report** will also contain an assessment of the investment fund managers and custodians compliance with the criteria stated in this Investment Policy. These quarterly reports will be made in writing and, on a regular basis, in person to the Board of Directors.

It is also desirable that each quarterly report be accompanied by a topic of interest to the Board concerning investment affairs that may satisfy requirements for continuing education. In order to measure the satisfactory achievement of investment objectives, the performance of each of the System's Funds, Pools and investment fund managers will be compared to appropriate benchmark indices and comparative performance universes.

Illustrated below are the relevant benchmark indices and comparative performance universes for the System's Pools and investment fund managers. These performance expectations will also be included in the Investment Fund Manager Directives.

A. Pool Comparisons

Pool/Fund Type	**Benchmark Index**
Total Fund	Sharpe Ratio Allocation Index
Cash Pool	Sharpe Ratio 50% 91-Day TBills/50% ML 1-3 Year Govt/Corp Cash Manager Universe
Fixed Income Pool	Sharpe Ratio S/L Aggregate Index Core Bond Mgr. Universe
Equity Pool	S & P 500 MGR. Style Universe

B. Investment Fund Manager Comparisons

Manager Type	**Benchmark Universe**
Cash	Cash Manager Universe
Fixed Income	Core Bond Mgr. Universe
Equity	Particular Style Universe

C. Specific Performance Criteria

1. Quarterly

Each manager's performance shall rank in the **top 50%** of a suitable universe consisting of managers employing similar Styles.

2. One Year

Each manager's performance shall rank in the **top 50%** of a suitable universe consisting of managers employing similar styles.

3. Three Year

Each manager's performance shall exceed that of an appropriate index based on management style **and** rank in the **top 33%** of a suitable style universe.

IX. COSTS

1. Fixed Income managers may not charge more than 0.60% in aggregate.

2. Cash and Short term bond managers may not charge more than 0.25% in aggregate.

3. The System may not pay more than 0.80% for all expenses, including the costs of its investment advisors, its consultant and its custodian.

4. The Entity may not purchase any investment that has a front end load, a rear end load, or a 12(b)1 fee, unless such fee or load is waived and there are no concurrent obligations associated with such investment.

5. The Entity may not purchase any portfolio investment, which has a total expense ratio higher than 1.25%.

6. The Entity may not purchase any investments, which do not offer liquidity through an active and open market, except after thorough analyses or except to facilitate other corporate business, as approved by the Board of Directors. Transactions

On a quarterly basis, the Investment Advisor shall review a complete list of dealers and brokers with whom the Managers are transacting business on the System's behalf. Such review shall indicate that the dealers in question continue to comply with standards of creditworthiness and efficient execution of transactions.

Any manager utilizing repurchase agreements for the System's benefit shall provide the System with a copy of the Master Repurchase Agreement and evidence of compliance with this Agreement.

X. DEFINITIONS

Asset Class

An asset class is a group or collection of investment securities, which exhibit broadly similar characteristics. Stocks, Bonds, Cash, Real Estate and International Stocks are examples of different asset classes.

Asset Allocation

Asset allocation is the term, which describes an investment portfolio's percentage mix of investment between different asset classes. For example, a portfolio may have an asset allocation of 30% Stocks, 60% Bonds and 10% Cash.

Custodian

A financial institution which acts as a fiduciary by holding an investor's investment assets in custody (safekeeping). Custodians typically provide monthly accounting statements, which describe how much the investments are worth as well as what, if any, activity has occurred in the portfolio during the month.

Futures

Futures are contracts for the purchase or sale of a financial asset at some future date, based upon a fixed price today. Futures markets are significant in size and generally very liquid. Many investment managers utilize a combination of cash and futures contracts to synthetically reproduce the characteristics of a specific financial asset, such as a bond or stock index. Futures are also used for hedging purposes, particularly with currencies.

Gains/Losses (Unrealized/Realized)

Gains and losses are the terms used to describe changes in an investment's value relative to its original purchase price. For example, if the current value of an investment is lower than the amount originally paid for it, it has suffered a loss. That loss is said to be unrealized if that investment is still owned. If the investment is sold, the loss is said to be realized.

Highland Horizon

The Highland Horizon represents an organization's Financial Life. It is the cumulative measure of how well it is positioned to fund its future capital requirements at its selected financial quality standards. A healthcare organization's Highland Horizon is equal to its Remaining Life of Productive Plant **plus** the life implied by its Cash & Investment Reserves and Average Additional Debt Capacity. This Implied Life is equal to the organization's Average Age of Plant multiplied by its Funding Factor.

Options

Options, or options contracts, give the holder the right, but not the obligation, to either buy or sell a financial asset, over a certain time period. Options can be used for both investing and speculative purposes, and are often used as hedging vehicles.

Portfolio Efficiency

Investors make investments based upon the assumption that they will earn an investment return, which is directly related to the level of investment risk that they are willing to assume. Efficiency is the measure used to describe how well an investment converts risk to return. The higher an investment's efficiency, the better it converts risk to return. Consequently, an efficient investment portfolio is one that earns the highest rate of investment return possible per unit of investment risk taken.

Risk (Investment)

Investment risk can be broken into two primary types of risk; firm specific (credit risk) and market risk. Firm specific risk is the risk inherent in any security due to the individual circumstances of the security's issuer. Adverse experience of the issuer will adversely impact the security. Firm specific risk can largely be eliminated from an investment portfolio through diversification.

Market risk is the risk inherent in an overall asset class of securities. It is evidenced through volatility of short-term returns and is measured in terms of Standard Deviation. Regardless of how well a portfolio is diversified across a single asset class, it will still be subject to market risk. The most effect method to manage market risk is through asset class diversification. By investing in multiple asset classes, the investor is able to use the volatility inherent in one asset class to cancel out the volatility of another asset class.

Sharpe Ratio

The Sharpe ratio is an effective measure of the risk-adjusted return of the portfolio. The formula is:

$$\frac{\text{Portfolio Return} - \text{Treasury Bills}}{\text{Portfolio Standard Deviation}}$$

Over a performance period, we would expect the Sharpe Ratio to exceed .55.

Style (Investment Fund Manager)

The best professional investment fund managers use a very disciplined approach (style) to the investment process. That is they buy and sell securities based upon certain criteria which remain consistent over time. These criteria heavily influence the types of securities that the investment fund manager buys. As a result, the investment fund manager's investment returns tend to reflect this style over a market cycle. The investment returns earned by other investment fund managers using the same or similar investment style will tend to track closely over time. Growth stocks managers, Core managers, Small company managers and Value managers are all example of equity manager investment styles.

Since different investment styles tend to produce similar results over the long-term, but different results over the short-term, it is possible to lower an investment portfolio's short-term volatility by diversifying its management between investment fund managers which use different investment styles.

Pools (Investment)

Pools, as used in this Policy, describe the investment Pools established under the Centrally Managed Investment Program for the purpose of commingling the investment portfolios of different investment fund managers who are managing assets within the same asset class. The Pools currently established under the Investment Program are: the Cash Pool and Fixed Income Pool.

Time Horizon (Investment)

An investment time horizon is the time frame over which an investor expects to hold an investment. Because investment returns are volatile (unpredictable) over the short-term, an investor with a short investment time horizon would have to invest in relatively conservative, short-term oriented investments (Treasury bills). Because the volatility of investment returns tends to cancel itself out over longer periods of time, an investor with a long investment time horizon can afford to be indifferent to the volatility of investment returns in the short run and invest in more aggressive, longer-term oriented investments (Stocks and bonds).

Total Return

The total return of an investment is the sum of the income (dividends/interest) generated by the investment plus the changes in the investment's capital value (capital gains/losses).

Value at Risk

Value at Risk is a measurement process intended to measure the downside risk of a portfolio of securities at a point in time. The measurement stipulates a worst case occurrence at;

- a given confidence level
- over a particular holding period

Value at Risk (VAR) is a key policy component, implementation consideration, and a priority constraint.

Volatility

Volatility, as measured by standard deviation, is a measure of uncertainty or risk of return. Standard deviation measures the extent to which an investment's returns have varied around the investment's average return over time. Extensive variations (high volatility/high standard deviation) around the average would indicate great uncertainty regarding the return to be expected over the short-term.

Yield

Yield is the income (dividends or interest) generated by an investment expressed as a percentage of the investment's total value.

SAMPLE

Investment Manager Directives

XYZ Fixed Income Manager

XYZ Fixed Income Manager has been selected by Lee Memorial Health System - (Lee Memorial), to manage an allocation in their Fixed Income Style. The assignment shall be carried out according to the directives which follow and the attached Policy and Guidelines.

I. General Information

A. Custodian: XYZ

- **Master Account Number**: 123-45-678
- **Investment Account Number**: 987-65-432
- **Trust Officer:**
- **Phone #:**
- **Fax #:**

Mailing Address **Street Address**

Authorized Parties of Lee Memorial:

Name	**Title**	**Signature**
________________	________________	____________________
________________	________________	____________________
________________	________________	____________________

You are authorized to accept verbal directions from Lee Memorial's authorized parties but such verbal instructions shall be confirmed in writing within 3 business days.

B. Consultant

Street Address	Mailing Address
Highland Associates	**Highland Associates**
c/o Consultant	c/o Consultant
2545 Highland Avenue, Suite 200	P.O. Box 55469
Birmingham, AL 35205	Birmingham, AL 35255

Phone (205) 933-8664

Fax (205) 933-7688

Our Consultant is not authorized to issue trading instructions on our behalf. However, we do ask that you respond to any request for information they may make on our behalf.

II. Performance Measurement

A. Benchmark:

Lehman Brothers Aggregate Bond Index

B. Ranking Criteria:

Quarterly: **Top 50%** of Fixed Income Universe

One Year: **Top 50%** of Fixed Income Universe

Three-Year: Outperform benchmark and rank in the **top 33%** of Fixed Income Universe

C. Miscellaneous:

Performance is not the sole criteria for continued retention, but rather a judgment as to XYZ's continued suitability to manage money for Lee Memorial.

III. Securities Eligibility and Restrictions

A. Eligible Securities

The aggregate duration of the Fixed Income Pool shall not exceed that of the Lehman Brothers Aggregate Bond Index by +\- 25%.

Security	Maximum Maturity
Treasury Bills, Notes & Bonds	No Limit
Agency Notes & Bonds	No Limit
Repurchase Agreements	No Limit
Bank Certificates of Deposit	No Limit
Bankers Acceptances	No Limit
Commercial Paper (P2 or better)	No Limit
Domestic Corporate Notes & Bonds (BBB or better by 1 of 2 major rating agencies)	No Limit
Asset-Backed Securities except those backed by LBO loan participations	No Limit
Eurodollar C.D.'s and Time Deposits	No Limit
Investment Grade Yankee Bonds (BBB or better)	No Limit
Collateralized Mortgage Obligations (AA or better) *	No Limit
GICs	No Limit
Insurance Contracts	No Limit

B. Securities to Watch.

Securities which are not prohibited by the Board of Directors, but which must be analyzed and accepted by the Board of Directors as an asset class (not individually) before use are to include:

1. The use of Options and Futures as a hedge; and

2. Derivative securities upon specific approval in advance, and meeting criteria established for derivatives.

C. Derivatives.

1. XYZ shall purchase a security whose value is derived from a different asset class or security type, and whose basic structure could change fundamentally due to market movement in the asset class or security type from which the security's characteristics are derived. This means that XYZ may not purchase a bond

whose price is affected by another asset class, such as the movement of the S&P 500 stock index.

2. XYZ may not create leverage within the portfolio through the use of securities, which have been purchased but not yet paid for or delivered, or in any other form. At no time shall XYZ purchase securities, which would create an obligation greater than the amount of assets available to pay for such securities. XYZ may not speculate through the use of Options and Futures, but may employ these securities as a means of reducing cost or reducing risk.

3. Collateralized Mortgage Obligations (CMOs) and Structured Notes - CMOs and Structured Notes shall not be purchased by XYZ unless the risks have been adequately measured and understood by System Management with respect to both the individual security and its impact on the risk of the entire portfolio. Specific risks include, but are not limited to: duration, convexity, yield curve, prepayment, liquidity, credit and counterparty risk. Securities should also be “stress - tested” to determine the effects of changing prepayments, interest rate levels, yield curve shape, and volatility in projecting prices. Additionally, the portfolio’s risk should measured in terms of absolute risk (the probability of incurring a negative return) and relative risk (the probability of under or outperforming the appropriate benchmark).

4. Should XYZ be given permission to own derivative securities, it must be willing to answer a risk questionnaire on a regular and timely basis.

5. Options and futures contracts may be used by investment fund managers who have demonstrated an ability to add value with these securities within an acceptable levels of risk may purchase these securities with the specific written approval of Lee Memorial Management.

D. Limitations

1. Mutual funds, unit and collective trusts, and bank and insurance company commingled accounts holding eligible securities are acceptable if there is a demonstrated advantage gained from such funds, and costs meet policy standards.

2. No corporate fixed income issue shall represent more than **5%** of any portfolio at the time of purchase, nor shall any single corporate position exceed **10%.**

3. In no event shall the Entity purchase, or have purchased on their behalf, equity or debt securities issued by hospital management companies or related real estate investment trusts.

4. The System may purchase insurance contracts in the Fixed Income Pool if the following circumstances exist:

   a) The insurer’s claims paying ability shall be rated at least AA by 2 of the 3 rating services;

   b) The contract shall be secured by assets held by the insurer in a separate account;

c) The return earned on the assets shall be "passed through" in the contract or the insurer shall pay a guaranteed rate of return;

d) Book Value withdrawals shall be allowed to some degree;

e) Market value withdrawals shall be unlimited unless negotiated otherwise;

f) AHS retains full authority to direct how the underlying bonds are invested and to retain the investment manager of their choice.

IV. Notification Required

Notification is required if any of the following events should occur.

A. XYZ should have a meaningful change in ownership and/or if an institutional entity should acquire an ownership position.

B. If any of the **X** individuals presently owning the firm should leave for any reason;

C. If there is any turnover in the Trading Team;

D. If there is any change in the constituency of the Investment Policy Group or the Strategy Group.

E. If the non-dollar component of the portfolio should exceed **XX%** of the portfolio.

F. If the portfolio manager should change or otherwise assume additional duties which dilute his time as applied to Lee Memorial.

Directive Issued by	**Directive Accepted by**
Lee Memorial	**XYZ**