

THE TENNESSEE BACCALAUREATE EDUCATION SYSTEM TRUST

INVESTMENT POLICY

Authority for investing and reinvesting the assets of the Tennessee Baccalaureate Education System Trust (Trust) is vested in the Board of Trustees (Board), T.C.A., Section 49-7-805. Implementation of investment policy established by the Board is hereby delegated to the State Treasurer (Treasurer) who shall put such policy into effect, T.C.A., Section 49-7-816. Assets may be invested in any instrument, obligation, security or property that constitutes legal investments for assets of the Tennessee Consolidated Retirement System, T.C.A., Section 49-7-814. If the Board has issued other directions further limiting such investments, the assets shall be invested according to the criteria established by the Board.

As authorized in T.C.A Section 49-7-802, the Baccalaureate Education System Trust is composed of two plans: the educational services plan, or "prepaid plan", and the educational savings plan, or the "savings plan".

Educational Services Plan

ORGANIZATIONAL STRUCTURE

Legal Counsel

The State Attorney General or an assistant designated by him shall be the legal advisor to the Board in all matters. In all cases where the interests of the Trust require additional counsel to the Attorney General, the Chairman of the Board, with approval of the Attorney General, is authorized to employ such additional counsel.

Delegation of Investment Responsibility

The State Treasurer may delegate the day to day management of the Trust to the Chief Investment Officer of the Treasury Department.

Initially, the Chief Investment Officer will assume the necessary authority, as granted by the Treasurer, to effectively manage the Trust portfolio. He shall report to and consult with the Board in formal, scheduled meetings and informally as needed.

The Chief Investment Officer shall:

1. Have executive responsibility and authority, as delegated by the Treasurer, for the management of the assets of the Trust in keeping with such guidelines and policies as approved by the Board and such applicable laws of the State of Tennessee.
2. Prepare and submit reports, as required, to the Treasurer, and the Board to document investment activities.
3. Report to and consult with the Treasurer on administrative, organizational and investment activities.
4. Work with the Treasurer on development and implementation of an appropriate investment strategy and long-term economic and investment projections.

INVESTMENT OBJECTIVES

Preservation of principal value is the primary objective in managing the Trust's assets. Within acceptable risk levels, achieving a superior return (both income and appreciation) is the second objective for the Trust. A third objective is to provide the liquidity needed by the Trust to pay Trust beneficiaries and educational institutions in a timely manner.

Preservation of Principal Value

Recognizing that potential investment return is proportionate to the amount of risk taken, investment in high quality assets shall be favored over those more risky investments that, if successful, can pay a higher return. In addition to limiting investments to higher quality financial assets, a diversified portfolio shall be maintained to further reduce exposure to loss. Although the risk parameters imposed by state law shall be followed, the investment staff may choose to further restrict the financial criteria, depending on the overall state of the economy.

Investment Returns

The Trust's assets should be managed to attain, within acceptable risk limitations, a return on assets that will achieve a return equal to or greater than the return set out in the section of this policy titled "Total Fund Performance Measurement Standards". This objective is not to be a goal from year to year, but is intended as a long-term guideline to those involved in investing the Trust's assets. Return shall include both current income and capital appreciation. The investments of the Trust shall be diversified so as to minimize the risk of large losses, unless under particular circumstances it is clearly prudent not to do so.

Liquidity

The Trust should be managed in a manner so that funds will be available to provide payments to Trust beneficiaries in accordance with the terms and conditions of the Trust. The Chief Investment Officer shall obtain annual long-term cash flow projections from the Director of the Trust program. Such projections may be utilized by the Chief Investment Officer for asset allocation and investment strategy purposes in order to meet the liquidity needs of the program.

GENERAL GUIDELINES

Reporting

The Treasurer shall be responsible for maintaining the following investment records on investment:

- a. **Detailed Investment Records:** The Treasurer's office shall maintain detailed computerized records of all Trust investments and investment transactions. The Chief Investment Officer shall submit the following reports at least annually to the Board and more often as deemed appropriate.
 - (1) Report reflecting summary information on each investment asset class.
 - (2) Report reflecting investment performance of each asset class and the total portfolio.
 - (3) Other information deemed pertinent for the Board's consideration.
- b. **Treasurer's Annual Report:** The annual financial report of the Treasurer for each fiscal year shall provide portfolio information.

General Provisions

The brokerage firms, proxy voting, commission dollar arrangements and any securities lending program shall be under the same terms and conditions as set out in the investment policy for the Tennessee Consolidated Retirement System.

INVESTMENT CRITERIA

In determining compliance with the percentage limitations of this policy, the assets of the Trust shall be valued at their market value. Accordingly, an investment may be made on any given day provided such investment does not cause any applicable limitations prescribed in this policy to be exceeded on such day.

PERFORMANCE MEASUREMENT

To provide the Investment Staff and the Board with guidance as to investment performance expectations, the following performance measurement standards are established. These standards are to act as guides in determining whether the Fund and individual asset classes are achieving their long term goals, both in relationship to the Trust's peer group of other public funds and the marketplace in general. In recognition of the Trust's long term perspective, these standards are to be measured through use of a five-year rolling average. This serves to reinforce the Trust's bias against investment decisions designed to show short term gain at the expense of long term performance.

Total Fund Performance Measurement Standards

This set of standards is designated to measure the performance of the Trust in total, including the impact that state law, investment, policy restrictions and asset allocation decisions may have on the performance of the Trust. Given the current state law, investment policy and asset allocation parameters, the following standard is considered a reasonable expectation for the total Trust:

- The Total Trust should provide a return at least equal to a benchmark calculated from index returns weighted by the target asset mix. The target asset mix shall be 35% US Equities, 19% International Equities, 44% US Bonds, and 2% US Cash Equivalents. However, in recognition that the Plan is no longer selling tuition units, the Trust assets will be managed so as to minimize the likelihood of a shortfall in assets in satisfying liabilities. Therefore, the Chief Investment Officer, with the concurrence of the Treasurer, may determine that a more conservative allocation is appropriate. The Board shall be notified of such decision in writing in a timely manner.

Asset Class Performance Measurement Standards

Initially, investments will be made in index funds; however, as the fund grows active, management strategies may be employed. Since an alternative to active management exists in the form of index funds, it is proper to measure the Trust's performance against the most appropriate index for each asset class to determine the "value added" over time by active management. As asset classes change, indices should be reviewed to ensure that proper comparisons are being made. The following indices provide for appropriate comparison to the Trust's current asset classes:

<u>Asset Class</u>	<u>Index Benchmarks</u>
US Equities	S & P 500
International Equity	EAFE
US Bonds	Lehman Brothers Aggregate Bond Index
US Cash Equivalents	90-Day US Treasury Bills

Returns are expected to exceed the benchmarks over rolling five-year periods.

Fund Benchmark

The Board has adopted the following asset ranges:

<u>Asset Class</u>	<u>Range</u>
US Equities	0-37%
International Equity	0-20%
US Bonds	42-100%
US Cash Equivalents	5-100%

Rebalancing

The portfolio shall be rebalanced to the target asset mix at least quarterly unless the Chief Investment Officer determines, and the Treasurer concurs, that circumstances warrant otherwise. This decision shall be documented in writing.

APPROVED INVESTMENTS**Common, Preferred Stock and Convertible Bonds**

Growth is important to the Trust to attain a return that will allow for meeting liabilities. Equity investments will be used to seek this growth through potential dividend increases and capital appreciation. Convertible bonds also will be counted as an equity investment.

Notes, Bonds, and Mortgages

Public issues of notes and bonds shall make up the majority of fixed income investments. Bonds generally will be purchased and held to maturity, but it will be necessary to actively manage this sector of the portfolio in times of volatile interest rate swings to either shorten the average maturity to protect principal value or lengthen maturities to lock up a long-term stream of income. The Trust may acquire securities which are rated within the four highest grades (investment grade) by any of the recognized rating agencies at the time of acquisition.

Short-term Investments

All monies waiting to be placed in a more permanent investment should be actively managed to obtain the best return available. Yield should be sacrificed for safety in short-term investments, and, thus, only the highest quality short-term debt issues should be purchased. These investments can include both publicly and privately negotiated short-term borrowing agreements. Commercial paper should be rates A 1 or P 1.

Passive Investment Strategy

Index funds may be utilized as an alternative to selecting individual securities. An index fund may be a pooled or co-mingled fund. Any securities listed in the index fund is an authorized security under this investment policy. It is recognized by this policy that a pooled or co-mingled fund may use strategies utilizing futures and/or options as a tool to deploy investment of cash and to meet liquidity needs of the fund.

External Management

If determined to be in the best interest of the prepaid plan and the savings plan, the State Treasurer is authorized to contract for outside management for the prepaid plan.

Additional Permissible Investments

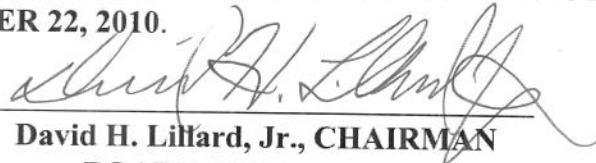
In addition to the investments set forth above, Trust assets may be invested in any other instrument, obligation, security or property that constitutes legal investments for assets of the Tennessee Consolidated Retirement System.

Educational Savings Plan

Oversight

The State Treasurer is authorized by statute to contract with another state 529 college savings plan for the purpose of providing a program that Tennessee citizens may utilize that will assist them toward the saving for the expenses associated with a child's college education. The Treasurer shall periodically review the investment objectives and investment performance of the plan that Tennessee has a contract with. The Treasurer shall at least annually report investment performance to the Board and shall compare such performance to applicable benchmarks.

**THE BOARD OF TRUSTEES OF THE TENNESSEE BACCALAUREATE
EDUCATION SYSTEM TRUST ADOPTED THIS POLICY AT ITS BOARD
MEETING ON NOVEMBER 22, 2010.**



**David H. Lillard, Jr., CHAIRMAN
BOARD OF TRUSTEES**

TENNESSEE BACCALAUREATE EDUCATION SYSTEM TRUST