


# Commonwealth of Pennsylvania Public School Employees' Retirement System

DATE: November 26, 2008

SUBJECT: Proposed Revisions to Investment Objectives and Guidelines for the Securities Lending Program

TO: Members of the Finance Committee

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At the December Finance Committee meeting, staff will recommend that the Finance Committee adopt the proposed Investment Objectives and Guidelines for the Securities Lending Program (Addendum Z). All changes in the Investment Objectives and Guidelines have been black lined for your convenience in reviewing the changes. Substantive changes to the Addendum Z are based on observations of the Investment Office Staff. If you have any questions or comments regarding these changes, please contact me at 717-720-4703. The more substantive changes proposed are as follows:

## **Overall**

All references to Participating Funds (the Public School Employees' Retirement System, the State Employees' Retirement System, and the Pennsylvania Municipal Retirement System) have been eliminated since each fund's securities lending pool is no longer commingled together into one account. Now each fund's securities lending pool is managed in its own separate account.

## **General Lending Guidelines**

Restricted the security loan terms to 14 days and required provisions for the immediate recall of securities at PSERS' discretion.

## **Cash Collateral Guidelines**

### **Acceptable Cash Collateral Investment Instruments**

- Added clause which reserves PSERS' right to require the Contractor to liquidate specific positions in the cash collateral pool for any reason.
- Strengthened the collateral requirements for longer dated repurchase agreements in recognition that longer-dated securities posted as collateral carry additional risk, and therefore, demand higher collateral to compensate for that risk.

- Added short-term rating requirements for instruments issued by U.S. corporations including corporate notes and floating rate notes to better match the short-term liquidity requirement of the investment instrument to the applicable short-term credit rating. If no short-term ratings exist, the long-term rating will be used.
- Clarified that sub-prime and Alt A asset-backed securities are prohibited to reduce the overall risk in the portfolio.
- Eliminated the ability to use the Mellon GSL Euro Fund.

#### **Maturity and Duration Constraints**

- Reduced the weighted average life of the collateral investment portfolio from 60 days to 45 days to make the portfolio more conservative and reduce the potential event risk to any one issuer.
- Reduced the projected average life and final stated maturity limits for fixed-rate asset-backed securities to make the portfolio more conservative and reduce the potential event risk to any one issuer.
- Reduced the maximum term for floating rate and variable rate securities to make the portfolio more conservative and reduce the potential event risk to any one issuer.

#### **Diversification Standards**

- Reduced the maximum permitted allocation for any one issuer, corporate sectors, and asset-backed securities to promote greater diversification within the portfolio.
- Increased the maximum permitted allocation to obligations of U.S. Treasury sponsored agencies (Fannie Mae, Freddie Mac, etc.) to allow for greater investment in a segment of the market where there is increased safety.
- Increased the maximum permitted allocation to repurchase agreements with a single counterparty because there are fewer institutional counterparties in the market.
- Required to maintain at least 20% of the portfolio in overnight (next business day) liquidity.

#### **Non-Cash Collateral Guidelines**

- Eliminated irrevocable letters of credit from the list of acceptable non-cash collateral to reduce the overall risk in the portfolio.
- Eliminated equity index baskets from the list of acceptable non-cash collateral to reduce the overall risk in the portfolio.

#### **Grandfather Clause**

- Existing positions in compliance with the previous set of investment guidelines may be retained at the Contractor's discretion.
- All new purchases must be in compliance with the latest set of guidelines approved by the Board of Trustees.
- PSERS' share of the Mellon GSL Euro Fund is to be eliminated through the transfer of a vertical slice of the Fund into a separate account no later than January 1, 2009.