

Commonwealth of Pennsylvania Public School Employees' Retirement System

DATE: November 24, 2009

SUBJECT: Proposed Revisions to the Investment Policy Statement, Objectives and Guidelines

TO: Members of the Finance Committee

FROM: James H. Grossman, Jr., CPA, CFA
Managing Director of External Public Markets, Risk & Compliance

At the December Finance Committee meeting, staff will recommend that the Finance Committee adopt the proposed change to page 9 to the Investment Policy Statement, Objectives, and Guidelines relating to the statistical probability of investment losses at the Fund level in excess of 12%. Given the decrease in expected returns for the various asset classes, to structure a portfolio with an expected return of 8%, the statistical drawdown risk is now closer to 14% than to 12%. In addition, staff wanted to leave some cushion for changes to Wilshire's forward looking expectations which may increase the drawdown risk of a suitable allocation to achieve the assumed actuarial rate of return to be voted on in the December Board meeting. As such, staff is recommending that this constraint be changed from 12% to 15%. I will be discussing this in my presentation at this meeting.

If you have any questions, please contact me.

- Clearly communicating members' and employers' rights and responsibilities; and
- Effectively managing the resources of the System.

Fiduciary Standard

As fiduciaries, the members of the Board and Staff must act solely in the interests of the members of the System and for the exclusive benefit of the System's members. In performance of their duties, the members of the Board and Staff delegated with investment authority shall be held to the Prudent Investor Standard.

Outside Service Providers shall be held to the Prudent Expert Standard. The Prudent Expert Standard shall be reflected in the System's contracts with Outside Service Providers.

Investment Objectives

The overall objective of the System is to provide benefits to its members through a carefully planned and well-executed investment program.

A. **Return Objectives** – The overall return objective is to realize a return sufficient to achieve funding adequacy on an inflation-adjusted basis. Funding adequacy is achieved when the actuarial market value of assets is at least equal to the System's projected benefit obligations. The System has a return objective of meeting or exceeding the actuarial rate (currently 8.5%) over the long-term. In addition, the Board has the following broad objectives:

1. The assets of the System shall be invested to maximize the returns for the level of Risk taken; and,
2. The System shall strive to achieve a return that exceeds the Policy Index.

B. Risk Objectives

1. The assets of the System shall be diversified to minimize the Risk of losses within any one asset class, investment type, industry or sector exposure, maturity date, or geographic location. Failure to do so could seriously impair the System's ability to achieve its funding and long-term investment goals and objectives; and,
2. The System's assets shall be invested so that the probability of investment losses (as measured by the Policy Index) in excess of 15% in any one year is no greater than 2.5% (or two standard deviations below the expected return).

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C. Constraints

1. The assets of the System shall maintain adequate liquidity to meet required benefit payments to the System's beneficiaries.
2. The System's assets shall be invested in a manner that is consistent with the System's long-term investment horizon.
3. As a tax-exempt investor, the System's assets may be invested without distinction between returns generated from income and returns generated from capital gains.