

Commonwealth of Pennsylvania Public School Employees' Retirement System

DATE: November 19, 2010

SUBJECT: Caspian Recommendation

TO: Members of the Board

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

At the Finance Committee meeting in December, staff and Aksia will recommend that PSERS invest \$200 million in the Caspian Select Credit International Fund, Ltd. (CSCI), Class A shares. This fund is an event driven absolute return debt fund. CSCI focuses on three primary trading strategies: stressed/distressed securities, capital structure arbitrage, and value shorting.

Caspian Capital Advisors (Caspian) was formed in 1997 under the Mariner Investment Group LLC (Mariner) umbrella. Mariner is a registered investment advisory firm which provides various infrastructure and support services to the Caspian managed funds that include but are not limited to risk oversight, legal and compliance support, back office services, administration, information technology and systems, human resources, and marketing support. Caspian personnel manage the funds as employees of Mariner. During the first quarter of 2011, Caspian will spin out of Mariner to become an independent registered investment advisor but will retain Mariner to provide the infrastructure and support services to Caspian and Caspian managed funds. PSERS has a relationship with Mariner for a residential mortgage backed securities portfolio managed by Galton Capital Group.

Caspian's three portfolio managers include:

- Adam Cohen, Caspian partner and partner of Mariner, who joined in 2001 from the proprietary distressed investing group at Goldman Sachs;
- Mark Weissman, Caspian partner and partner of Mariner, who started Caspian in 1997 whose background is as a proprietary trader with experience at Bear, Stearns & Co, Lehman Brothers, and Cantor Fitzgerald & Co; and
- David Corleto, Caspian partner and Head of Trading and Structuring at Caspian, who joined Caspian in 2005 from Goldman Sachs where he held positions including high yield research analyst, distressed research analyst, distressed bond trader and distressed loan trader.

Caspian manages approximately \$2.6 billion as of August 2010 in two separate products and five managed accounts. Caspian Capital Partners (CCP) is their longest running hedge fund that has had consistent performance since their inception in 1997 and has had only one down year during this period (2008). CCP has generated strong, statistically-significant risk-adjusted returns since inception with annualized returns of 11.6%. CCP was closed to new investors in 2008 and CSCI was opened in 2007 with a similar, but more liquid, strategy. Given the similar strategies, the returns for CSCI have been comparable with those of CCP since the inception of CSCI.

Caspian has a strong management team and operational platform with the support of Mariner. Caspian also has a strong risk management culture where preservation of capital is paramount and they use no net leverage to generate their returns. We anticipate that CSCI will generate low to mid double digit returns with single digit volatility.

Included for your review are a powerpoint presentation prepared by staff, Aksia's recommendation, and the resolution recommending an investment in CSCI.

If you have any questions or comments prior to the meeting, please contact me at 717-720-4703.

Manager Recommendation Memo

November 19, 2010

Board of Trustees
Pennsylvania Public School Employees' Retirement System
5 North Fifth Street
Harrisburg, PA 17101

Re: Caspian Select Credit International, Ltd.

Dear Trustees:

Aksia LLC, having been duly authorized by the Board of PSERS, has evaluated and herewith recommends a direct allocation to Caspian Select Credit International, Ltd, ("Caspian"). In the ongoing development of PSERS' portfolio of absolute return funds, Aksia recommends an initial allocation in line with Exhibit D of PSERS Investment Policy Statement, Objectives, and Guidelines.

Caspian is a fundamental distressed debt investor, but, unlike many credit hedge funds that focus solely on identifying long-biased, valuation based opportunities or making investments determined by macroeconomic analysis, Caspian allocates a significant amount of capital to relative value opportunities. As a result, the fund is subject to relative value market risk. According to the manager, they will often focus on mid-sized issuers within a larger capital structure in order to take advantage of relative mispricings.

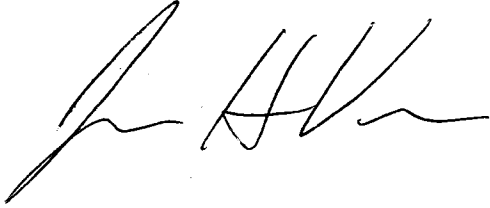
Aksia's recommendation is based upon the following analytical factors and is made within the context of PSERS' investment guidelines.

- Due diligence of Caspian's investment strategy, including a review of their investment strategy, investment team and structure, and risk management process.
- Due diligence of Caspian's operations, including an operations and infrastructure review, regulatory and compliance review, private placement memorandum review, Form ADV review, and financial statement review.
- Evaluation of the Caspian's investment strategy within the context of the current investment environment.
- Appropriateness of the Caspian fund for the Absolute Return component of PSERS' portfolio.

This recommendation is confidential, given solely for the benefit of PSERS and cannot be relied upon by other investors considering an investment in Caspian, since their needs, objectives and circumstances may not be identical to those of PSERS. The scope of this recommendation is limited to the investment merits of the Caspian fund. Aksia manager recommendation memos should be reviewed with other Aksia due diligence materials, including the full Investment Review and Operational Review. In addition, please consult your tax, legal and/or regulatory advisors before allocating to any private investment fund.

Please feel free to contact us should you have any questions about this recommendation.

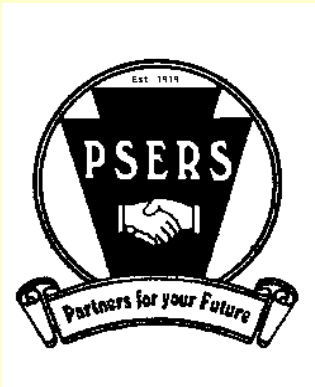
Respectfully,

A handwritten signature in black ink, appearing to read 'Jim Vos', with a long, sweeping underline.

Jim Vos
CEO and Head of Research

A handwritten signature in black ink, appearing to read 'Jaeson Dubrovay', with a large, circular flourish at the end.

Jaeson Dubrovay
Partner, Co-Head of Americas Advisory



Absolute Return Fund Allocation

Caspian Select Credit International, Ltd.

December 9, 2010

See Page 7 for Disclaimer

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

Caspian – Absolute Return Fund

Overview of Caspian Capital Advisors

- Caspian, a portfolio management group of the Mariner Group, essentially acts autonomously
 - Caspian will spin out of Mariner to become an independent registered investment advisor in the first quarter of 2011 but will maintain all existing services with Mariner
- Founded in 1997 by Mark Weissman, partner and co-portfolio manager of the Fund
- Adam Cohen, partner and co-portfolio manager, joined Caspian in 2001
- David Coletto, partner and Head of Trading and Structuring, joined Caspian in 2005
- Firm manages approximately \$2.6 billion in distressed, stressed, capital structure arbitrage and value short strategies
- Products include:
 - Caspian Select Credit International, L.P.: \$1.2 billion
 - Caspian Capital Partners, L.P.: \$660 million (closed strategy similar to Caspian Select Credit International)
 - Managed accounts/funds: \$700 billion

Investment Team

- 15 investment professionals based in New York, fully supported operationally by the Mariner Group

See Page 7 for Disclaimer

Caspian – Absolute Return Fund

Fund Strategy

- The fund focuses on three trading strategies:
 - Stressed/distressed securities;
 - Capital structure arbitrage; and,
 - Value shorting
- Strong risk management through portfolio construction
 - No net leverage and low to no adjusted net leverage
 - Highly diversified portfolio
 - Balanced portfolio of longs, shorts, and capital structure arbitrage positions

Caspian – Absolute Return Fund

Value Proposition

- Caspian has had strong investment performance – only one down year (2008) since inception in 1997
- Caspian has generated strong, statistically-significant risk-adjusted returns
 - Information ratio over past ten years ended October 31, 2010 was 1.23
- Unique among credit hedge funds
 - Allocates significant capital to relative value opportunities
- Strong risk management
 - Have a preservation of capital mentality
 - No net leverage and low to no adjusted net leverage
 - Diversification – average position size is approximately 1.5% and the largest positions rarely exceed 5%
- Strong management team and operational platform
- Liquid strategies – 90% of portfolio (under normal market conditions) is able to be liquidated within 30 days
- Disciplined asset growth

Caspian – Absolute Return Fund

Performance, net of fees

	1997	1998	1999	2000	2001	2002	2003
CCP*	10.08%	19.99%	22.14%	22.38%	13.19%	8.57%	14.74%
	2004	2005	2006	2007	2008	2009	2010**
CCP*	10.81%	8.07%	12.60%	4.93%	(17.60%)	27.14%	8.66%
CSCI***				0.60%	(11.34%)	30.23%	5.85%

* - Caspian Capital Partners, their longest running hedge fund closed to new investors, inception date March 1, 1997

** - through October 31, 2010

*** - Caspian Select Credit International Fund, inception date December 1, 2007

History with PSERS

- This would be PSERS first investment with Caspian
- We have invested with a sister organization within Mariner Investment Group called Galton

Annualized Fund Returns and Volatility of CCP Since Inception (3/1997)

- Annualized Return: 11.60%
- Excess Annualized Return over 1-Month LIBOR: 7.87%
- Annualized Volatility: 4.64%
- Sharpe Ratio: 1.70

See Page 7 for Disclaimer

Caspian – Absolute Return Fund

Fund Terms

- Management fee: 1.0% (for an investment of \$200 million or more)
- Performance Fee: 20% of the increase in NAV over the high water mark
- Hurdle rate: 0%
- High water mark: Yes
- Lock up period
 - 1 year hard lock
- Administrator: Butterfield Fulcrum Group (Cayman) Limited
- Auditor: J. H. Cohn (Cayman)
- Liquidity: Quarterly with 3 months notice
- Gate: 25% Investor Level Gate
- Transparency: Partial
- Side Pockets: No

Caspian – Absolute Return Fund

Other

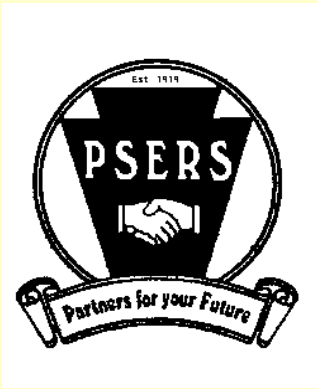
- Relationships with Aksia: None
- Placement Agents: Mariner Group Capital Market, Inc., an affiliated limited purpose broker dealer
- Political Contributions in PA: None

Caspian – Absolute Return Fund

Recommendation

Staff, together with Aksia LLC, recommends that the Board invest in the Caspian Select Credit International, Ltd., class A shares, in an amount within the target ranges established in Exhibit D of the Investment Policy Statement, Objectives and Guidelines.

DISCLAIMER: This document was presented to the Public School Employees' Retirement Board at the public meeting at which the Board acted on the resolution to which the information relates. The sole purpose for posting the presentation information on this website is to enable the public to have access to documents that were utilized at a public meeting of the Public School Employees' Retirement Board, and no other purpose or use is intended.



Absolute Return Fund Allocation

Caspian Select Credit International, Ltd.

December 9, 2010

See Page 7 for Disclaimer

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

**Proposed
PSERB Resolution 2010-_____
Re: Caspian Select Credit International, Ltd.
December 9, 2010**

RESOLVED, that the Finance Committee of the Public School Employees' Retirement Board (the "Board") hereby recommends that the Board invest in the Caspian Select Credit International, Ltd., Class A shares, in an amount not to exceed the target ranges established in Exhibit D of the Investment Policy Statement, Objectives and Guidelines pursuant to the recommendations of James H. Grossman, Jr., Managing Director of External Public Markets, Risk & Compliance, and Aksia, LLC, both dated November 19, 2010.

The final terms and conditions of the investment must be satisfactory to the Investment Office, the Office of Chief Counsel, and the Office of Executive Director, as evidenced either by the appropriate signatures on the implementing investment contract or by a memo to that effect appended to the implementing investment contract.