

Commonwealth of Pennsylvania Public School Employees' Retirement System

DATE: July 23, 2010

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

TO: Members of the Board

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

At the August Finance Committee meeting, Wilshire and staff will recommend that the Finance Committee adopt the proposed changes to the Investment Policy Statement, Objectives, and Guidelines (hereafter referred to as the Investment Policy Statement), including Addenda.

Wilshire will recommend changing the private real estate benchmark from the NCREIF benchmark that we are currently using to the NCREIF/Townsend Fund Index (NTFI) effective July 1, 2010. As discussed with the Board over the past year, the NCREIF benchmark is an unleveraged benchmark so the effects of leverage on the value-added and opportunistic segments of PSERS Private Real Estate Composite are not reflected in the current benchmark. Wilshire and staff searched for a benchmark more representative of the strategies and opportunities being sought by PSERS through the private real estate market, concluding that the NTFI is the best fit. Wilshire will be presenting the results of this search at the August Finance Committee meeting. The only changes to the IPS to reflect this recommendation are to pages 5 (definition) and Exhibit C on page 33 (Policy Index). The NTFI consists of three sub-indices (core, value-added, and opportunistic). Quarterly, based on PSERS' actual weightings to these three fund types, a customized, blended benchmark return will be independently calculated by our consultant. Similar to the NCREIF index, returns will be calculated with a quarterly lag.

As noted during the April and June Finance Committee meetings, we are continuing our annual process of bringing investment objectives and guidelines to the Board for your approval. We have continued to re-engineer our guidelines to link the various risks in the portfolio we seek to manage to the Board approved portfolio constraints. By streamlining the guidelines, we will provide the manager with clear, specific, understandable constraints for the risks we are addressing.

At the last meeting, the Finance Committee approved the guidelines for multiple fixed income portfolios. At this meeting, we will be seeking approval for the following Enhanced U.S. MLP index, commodity and currency addenda:

<u>Addendum</u>	<u>Addendum Title</u>
B	Enhanced U.S. Master Limited Partnership Index Portfolios
H	Full Discretion Commodity Program
H1	Enhanced Commodity Index Program
P	Active Currency Hedging Overlay Program
P1	Active Currency Program

Given the magnitude of the structural changes to the guidelines, we have included both the old guidelines (approved June or August 2009) and the proposed guidelines (proposed August 11, 2010) for your review.

The commodity guidelines (Addenda H and H1) include a new guideline on credit spread risk, or the risk the portfolio has to widening credit spreads. Otherwise, there are no material differences in the portfolio constraints between the old and the new versions. In general, we tried to maintain or lower the risk levels in the various guidelines.

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