

Commonwealth of Pennsylvania Public School Employees' Retirement System

DATE: November 18, 2016

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

TO: Members of the Board

FROM: Joseph W. Sheva, CPA 
Risk Manager

At the December Finance Committee meeting, staff will recommend that the Committee adopt structural revisions to the Investment Policy Statement, Objectives and Guidelines (IPS) and changes to Private Market and Real Estate Discretionary Structure Capital Limits, in the Risk Management and Controls section.

- **Reformatting the IPS**

Staff recommends adoption of a revised structure to the IPS. The proposed structural changes are reflected in the proposed table of contents below, which will provide improved categorical flow around topics most relevant to the Board regarding communicating its Investment Policies. Adoption of the new structure does not change the contents of the IPS at this point. The revised Table of Contents is organized around the following subject areas:

- I. Introduction and Purpose
- II. Roles and Responsibilities
- III. Investment Objectives
- IV. Strategic Asset Allocation
- V. Performance Objectives
- VI. Risk Management and Controls
- VII. Monitoring and Reporting
- VIII. Definitions

- **Private Market and Real Estate Discretionary Structure Capital Limits**

Staff recommends an increase of \$50 million, to a total of \$500 million, for the Private Market In-House Co-Investment and Secondary Investments Capital Limit, which is requested due to the potential for additional investment opportunities. The proposed limit is an appropriate amount of risk control for this strategy.

IPS re-write project:

The existing IPS is long, containing over 500 pages of documentation ranging from governance matters to detailed staff implementation guidance. A well-defined and clearly articulated IPS should establish the Board's objectives, including its tolerance of total portfolio risk. Board Trustees are the highest level fiduciaries, maintaining broad responsibilities with limited time and ability to reasonably attend to a broad array of important matters across the Fund. The IPS is the Board's core tool to define the overall governance structure within the investment program and ensure that those delegated roles and responsibilities act as fiduciaries in satisfying their obligations; its level of detail should differentiate between the important matters that the Board expects to directly manage and those it entrusts to others, subject of course to the Board's oversight. The Board is ultimately responsible for ensuring that appropriate policies governing management of PSERS' assets are in place, and that they are implemented. With respect to the investment program, the primary resource the Board has to implement its priorities and manage day-to-day investment activities is PSERS' Investment Office staff. A well-designed IPS, therefore, should contain only the most important aspects of the guidance necessary for the Board to fulfill its' fiduciary responsibilities, and then delegates the responsibility for implementation and ongoing monitoring.

At the March Finance Committee meeting Investment Office staff expects to propose additional changes to the IPS. These proposed revisions will include the following:

- Updating and expanding the Roles and Responsibilities section to include those with responsibilities within the construct of an Investment Policy Statement, such as Internal Audits.
- Updating and expanding upon the Introduction and Purpose section to include information that would typically be found within an IPS.
- Revision of delegation and oversight language resulting from a thorough review the existing IPS through the prism of what responsibilities a fiduciary should delegate to others to align objectives, policies, and best practices.

Blacklined and clean copies have been included in the package for your review.

If you have any questions or comments, please contact me at 717-720-4632.



COMMONWEALTH OF PENNSYLVANIA
PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM

PSERS Investment Risk Management Update

Joseph W. Sheva, CPA
Risk Manager

December 6, 2016

Table of Contents

- **Investment Risk Management Framework**
- Investment Policy Statement (IPS) Re-write

Investment Risk Management

The purpose of **risk management** is to

- Identify possible risks
- Reduce or allocate risks
- Provide a rational basis for better decision making in regards to all risks
- To plan

The **Goal** of the Risk Management Group is to systematically and methodically identify, assess, manage, monitor, and document IO Risks by using a formalized risk framework



Investment Risk Framework

The purpose of a **risk structure** is to become organized around broad risk topics in order to ensure possible risks are identified, to prioritize work flow and resources around the key and significant risks.



Investment Risk Framework

The purpose of **risk standards** are to establish norms to assess whether we are “living up to a set of (risk) standards”

PSERS Risk Standards	
Risk Standard	
1	Acknowledgment of fiduciary responsibility
2	Approval and Monitoring of Investment Policies, Guidelines, Documentation and Due Diligence Processes.
3	Independent risk oversight, checks and balances, written procedures and controls
4	Clearly defined organizational structure and key roles with Adequate Education, Systems, Resources and Back-up
5	Risk Policies Established and Consistently Applied
6	Ongoing Identification and Analysis of Key Risks and New Strategies
7	Reporting, Exception Reporting and Escalation Procedures
8	Valuation Procedures and Reconciliation
9	Risk Measurement and Risk/Return Analysis
10	Stress Testing
11	Independent and Ongoing Analysis of Investment Inputs and Methods
12	Cost Effective Analysis

Staff Implementation of Risk Structure

Market Risk:

- Document structure along with processes and procedures used to capture information

Fund & Portfolio:

- Largest area, shared by all in some manner
- Structure evolving - established Investment Office Staff (IOS)

Committees:

- IOS Asset Allocation Committee (AAC) - established Charter
- IOS Allocation Implementation Committee (AIC) - established Charter
- IOS Risk Oversight Committee (ROC) - Charter establishment in progress. Committee overseeing all risks within the risk structure

Staff Implementation of Risk Structure

Operational Risk:

- Structure created – established Operations Committee
- Large and shared area of responsibility – not just Investment Operations Group
- Example of Risk Standard (RS) applied: RS 11 - Independent and Ongoing Analysis of Investment Inputs and Methods – *need for Investment Book of Record*
- Operational Due Diligence
- Updated Board June 2016

Liquidity, Leverage and Finance Risk:

- Structure established
- Working groups output presented to the Board
- Significant oversight in IOS Committees

Staff Implementation of Risk Structure

Legal Risk:

- Structure established and confirmed by ROC
- Identified many significant risks are out of IOS control due to overarching governance structure

Organizational Risk:

- Structure created and confirmed by ROC
- Performed thorough Organizational Risk review
 - Identified certain risks, such as understaffing are out of IOS control due to overarching governance structure
 - Identified complexity, when paired with understaffing, as a fundamental risk
 - Example of Risk Standard (RS) applied: RS 3 – Independent risk oversight, checks and balances, written procedures and controls – progress being made. *In progress: procedures review of quality of control structure*

Table of Contents

- Risk Management Framework
- **Investment Policy Statement (IPS) Re-write**

Board IPS Re-write Step 1: Structure

New Table Of Contents	Mapping of Current Information to New Table of Contents
I. Introduction and Purpose	Purpose of Investment Policy Statement The Board Mission of Board Fiduciary Standard
I. Introduction and Purpose	<i>Implementation</i>
II. Roles and Responsibilities	Identification of Duties and Investment Responsibilities The Board Investment Office Staff Office of Financial Management Investment Consultants State Treasurer Investment Managers
III. Investment Objectives	Investment Objectives
IV. Strategic Asset Allocation	Asset Allocation
IV. Strategic Asset Allocation	Asset Class Rebalancing
IV. Strategic Asset Allocation	Investment Structure
IV. Strategic Asset Allocation	Index Portfolio Rebalancing
IV. Strategic Asset Allocation	Cash
IV. Strategic Asset Allocation	Allocation Approval Process
IV. Strategic Asset Allocation	Securities Lending Program
IV. Strategic Asset Allocation	Long Term Target Allocation
IV. Strategic Asset Allocation	Current Target Allocation
V. Performance Objectives	Return Objectives
V. Performance Objectives	Policy Index
VI. Risk Management and Controls	Risk Objectives
VI. Risk Management and Controls	Constraints
VI. Risk Management and Controls	Public Market Investment Manager Target Ranges
VI. Risk Management and Controls	Private Market Discretionary Structure Capital Limits
VI. Risk Management and Controls	Investment Objectives and Guidelines
VI. Risk Management and Controls	Derivatives Policy
VI. Risk Management and Controls	Securities Lending Program Policy
VI. Risk Management and Controls	Policy Regarding Placement Agents
VI. Risk Management and Controls	Public Markets Emerging Investment Manager Program Policy
VI. Risk Management and Controls	Qualified Independent Representative (QIR) Policy
VII. Monitoring and Reporting	Selection of Investment Managers
	Public Markets excluding the PMEIM Program
	Private Markets, including Private Debt, Private Equity, Venture Capital and Real Estate
VII. Monitoring and Reporting	PMEIM Program
VIII. Definitions	Termination of Investment Managers Definitions

Board IPS Re-write Step 2: March Meeting

Existing

- IPS
 - ❖ 58 pages of content
 - ❖ Inclusion of Portfolio/Program Guidelines
- Portfolio/Program Investment Risk Guideline Addendums to the IPS
 - ❖ 45+ Addendums and over 450 pages of content
 - ❖ 1 Healthcare Investment Risk Guideline
- Level of detail exposes Board to Fiduciary Liability
- Prudent Person vs. Prudent Expert

Future

- Organized around Board-level Oversight Topics (Adoption of new Table of Contents)
 - Retain discretionary authority and control necessary as Fiduciaries
 - Update sections lacking clarity
 - All non-retained responsibilities delegated to staff
 - Staff responsibilities documented via “Staff Implementation Policies”
 - ❖ Move from IPS to staff
- Examples:
- ❖ Derivatives and Securities Lending Policies
 - ❖ Risk Guidelines Addendums

Board vs. Staff Policy

Board Policy

- Top-level
- Driven by Fiduciary Duties
- Explicitly retain certain responsibilities
- All others delegated
- ***Steer the ship, set the course, but allow the staff to handle the rowing***

Staff Implementation Policies

- Details
- Management
- Day-to-day operations
- Tactical decisions
- Guided by Delegated responsibilities and authority
- Available for Board to reference and review



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Private Market and Real Estate Discretionary Structure Capital Limits

All allocations to individual Private Market and Real Estate Discretionary Structure (i.e. Separate Account, Open-end Fund, Co-Investment and Secondary Investment) strategies shall be subject to the limits established by the Board through the Current Target Allocation in the Strategic Asset Allocation section. IOS is permitted to manage the allocation of capital to each Private Market and Real Estate strategy up to the capital limits noted below. The CIO shall have discretion on the timing of reducing any strategy exceeding the limits approved below. However, the CIO is not permitted to allocate additional capital to those strategies currently above the limits.

Capital Limits

Private Markets:

Private Markets In-House Co-Investment and Secondary Investments	\$450-500 million
• \$15 million limit for each initial investment	
• \$25 million limit for each secondary investment	
• \$10 million limit for follow-on investments	
Private Debt In-House Co-Investment and Secondary Investments	\$100 million
• \$15 million limit for each initial investment	
• \$25 million limit for each secondary investment	
• \$10 million limit for follow-on investments	

Real Estate:

Open-end Real Estate Fund Investments	\$500 million
• \$200 million limit per open-end Real Estate Fund	
Farmland Investments	\$100 million
Real Estate In-House Co-Investment and Secondary Investments	\$300 million
• \$15 million limit for each initial investment	
• \$25 million limit for each secondary investment	
• \$10 million limit for follow-on investments	

Other:

Private Markets and Real Estate Pennsylvania In-House Co-Investments	\$250 million
• \$25 million limit for each initial investment	
• \$10 million limit for follow-on investments	