Commonwealth of Pennsylvania
Public School Employees' Retirement System

DATE: January 3, 2018

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

TO: Members of the Board

FROM: Joseph W. Sheva, CPA JWS
Senior Risk Manager

At the January Investment Committee meeting, staff will recommend that the Board adopt the Investment Policy Statement, Objectives and Guidelines (IPS) revisions to section VI. Risk Management and Controls as noted below.

Investment Manager Target Ranges:

- Staff recommends removing the references limiting this section to only public market investment managers. This section of the IPS is where the Board limits the concentration risk (i.e. the amount of capital exposure) to an individual firm's team by asset class and thus can be applicable to non-traditional investment managers, such as open-end fund investment structures. The structure of open-end fund investments implies that there is discretion of the timing and amount of investments into and out of the fund. For example, while liquidity of each open-end fund differs, there tends to be a greater ability to reduce allocated capital should such action be desired or necessary.

- Staff recommends adding the following limits for the non-traditional investment asset classes, Infrastructure and Real Estate, open-end fund investments:

	Capital as a % of Total Fund
Open-end Infrastructure Fund Investments	2.00%
Open-end Real Estate Fund Investments	1.00%

The limits are consistent with individual public market investment manager limits, by asset class, and are deemed appropriate and relevant due to the similarities of staff discretion with regards to timing and capital allocation to the strategies.

Clarity of Board-level risk controls are improved by the above recommendations.

Private Market and Real Estate Discretionary Structure Capital Limits:

- Staff recommends removing the limit of total amount of capital allocated to open-end Real Estate fund investments. Limiting the amount of open-end investment structures implies a risk that needs to be controlled, i.e. limiting open-end funds, while allowing for closed-end structures to be limited by the Strategic Asset Allocation. As the liquidity profile of the System is potentially improved by the allocation of capital to open-end funds, relative to closed-end funds, such a limitation is unnecessary, and potentially counterproductive in discussions of the System's liquidity profile.

- Staff recommends removal of the limit per open-end Real Estate Fund in this section and replacing it with the limit in the more appropriate section, Investment Manager Target Ranges, as noted above.

- Staff recommends adding a section for Infrastructure In-House Co-Investment and Secondary Investments and limiting the entire program to $500 million, while limiting each individual co-investment to $100 million. The concept of a co-investment program is to have the opportunity to participate in unique deals, typically at a lower fee than would be offered within an investment in a Fund structure. Therefore, significantly constraining co-investment capacity would potentially be counterproductive to a goal of investing in investments with a good risk/return profile at the lowest fee possible. The limits are consistent with the overall private markets In-house Co-Investment program, while establishing the $100 million limit for each investment in recognition of the potential size of opportunities in Infrastructure investments being greater, and opportunities fewer, than those in the Private Markets asset class.

I note that the tolerance maximums in the above recommendations are absolute without additional Board approval to increase them. The Investment Office Staff implements each investment strategy within these limits, while considering all aspects of the investment portfolio risks at a fundamental-level. For example, concentration risk, such as those noted above, are considered on an investment-by-investment and on an on-going basis in conjunction with other risks such as the liquidity profile of the System, investment operational risks, the impact to the overall risk profile of the System, etc.

The blacklined excerpt and a clean copy of the above recommendations have been included in the package for your review.

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