Commonwealth of Pennsylvania
Public School Employees' Retirement System

DATE: March 8, 2018

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

TO: Members of the Board

FROM: Joseph W. Sheva, CPA
Senior Risk Manager

At the March 8, 2018 Investment Committee meeting, the Committee determined that the following revisions, originally proposed as part of memos dated February 20th and March 1st, 2018, be included in a revised resolution. In the revised resolution, the Investment Office recommends that the Board adopt the Investment Policy Statement, Objectives and Guidelines (IPS) revisions sections V. Performance Objectives and VI. Risk Management and Controls as noted below.

V. Performance Objectives – Policy Index:

Staff, Aon and Courtland Partners, Ltd. recommend several key changes to the Private Real Estate performance benchmark calculation methodology, which are included as an attachment to this memo. In addition, Staff recommends that the benchmark change be effective July 1, 2017 for the current fiscal year, with the rolling 5-year (20 quarters) lookback being built out effective the first quarter 2015. The changes are expected to result in an improved performance metric for the Private Real Estate asset class. The Fund's overall risk profile is unchanged by this recommendation.

Section VI. Risk Management and Controls:

Sub-section Private Market and Real Estate Discretionary Structure Capital Limits:

The Investment Office recommends increasing the Private Markets In-House Co-Investment and Secondary Investments total program capital limit by $250 million, from $500 million to $750 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 primary Board-level risk controls for the various co-investment and secondary investment programs (e.g. Private Markets, Real Estate, etc.) are to limit the size of each program (e.g. the proposed $750 million above) and to place limits on individual investments within the program (e.g. $25 million limit for each initial investment and $10 million for follow-on investments). As stated above, significantly constraining the size of each program would potentially be counterproductive to other Board objectives and thus these limits should be thoroughly considered through a risk/return paradigm, particularly in light of the length and success of the various programs. Regarding the limits on individual investments, I believe that these are reasonable and necessary to the management of risk of the program, as they limit individual investment concentration risk (e.g. promote diversification) and therefore remain appropriate.

The Investment Office 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 revised recommendation have been included for your review.

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