

***Investment Policy Statement,  
Objectives, and Guidelines***

***of***

***the Commonwealth of Pennsylvania  
Public School Employees' Retirement Board***

**As adopted by**

**the Board of Trustees**

**on March 16, 2007**

**Effective March 16, 2007**

**INVESTMENT POLICY STATEMENT, OBJECTIVES, AND GUIDELINES  
FOR  
THE PENNSYLVANIA PUBLIC SCHOOL EMPLOYEES' RETIREMENT BOARD**

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**INVESTMENT POLICY STATEMENT, OBJECTIVES, AND GUIDELINES  
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**I. Definitions**

- A. **Asset Allocation:** the decision of selecting appropriate weights between broad asset class categories (Private Markets, bonds, cash, commodities, stocks, etc.) in order to produce the desired risk and return profile for a total fund portfolio. The Asset Allocation decision is the most important investment strategy issue for an investment program.
- B. **Benchmark:** a standard against which the performance of a security, index, or portfolio can be measured.
- C. **Board:** The Pennsylvania Public School Employees' Retirement Board.
- D. **CIO:** Chief Investment Officer.
- E. **Commingled Fund:** a type of fund consisting of assets from several accounts that are blended together. Sometimes called a pooled fund.
- F. **Commission Recapture Agent:** the party responsible for administering the Commission Recapture Program on behalf of a fund. See **Exhibit A** for the System's current Commission Recapture Agent.
- G. **Commission Recapture Program:** a program whereby a pension fund receives "credits" resulting from transactions incurred by the fund's investment managers on their behalf. These transactions may be from commissions (equities) or spreads (fixed income).
- H. **Commonwealth:** Commonwealth of Pennsylvania.
- I. **Custodian Bank:** an institution that keeps custody of stock certificates, fixed income securities, and other assets. The System's Custodian Bank has a contract with the State Treasurer, the legal custodian of the System's assets. See **Exhibit A** for the System's current Custodian Bank.
- J. **Developmental Fund:** a program established by the Board to assist emerging minority-owned, women-owned, and Pennsylvania-based investment management firms. The Developmental Fund is administered internally by the DFM.
- K. **DEPM:** Director of External Public Markets, Risk & Compliance.

- L. **DFM:** Developmental Fund Manager.
- M. **DJ/AIG Commodity Index:** a rolling commodities index composed of futures contracts on 19 physical commodities traded on U.S. exchanges. The index serves as a liquid and diversified benchmark for the commodities asset class.
- N. **DJ Wilshire 5000 Index:** a market capitalization-weighted index composed of over 6,000 publicly traded companies that meet the following criteria: a. the companies are headquartered in the United States; b. the stocks are actively traded on an American stock exchange; and, c. the stocks have pricing information that is widely available to the public.
- O. **DJ Wilshire Real Estate Securities Index:** a market capitalization-weighted index composed of publicly traded real estate securities, such as Real Estate Investment Trusts (REITs) and Real Estate Operating Companies (REOCs).
- P. **Derivative:** a security, such as a futures, option, or swap contract, whose value depends on the performance of an underlying security.
- Q. **DPMRE:** Director of Private Markets & Real Estate.
- R. **EPRA:** acronym for the European Public Real Estate Association. EPRA is a common interest group that promotes, develops, and represents the European public real estate sector.
- S. **Exchange Traded Funds (ETFs):** trust-issued receipts that represent beneficial ownership of a specified group of stocks. ETFs allow the holder to benefit from the ownership of the stocks or bonds in a particular country, industry, sector, group, etc. ETFs include HOLDRS, iShares, SPDRs, etc.
- T. **External Portfolio Manager:** an individual or firm with whom the Board has a contract to manage an investment portfolio.
- U. **Frictional Cash:** cash that is held by a portfolio that is not benchmarked to the asset allocation category of cash. For example, cash held in an S&P 500 index fund would create a performance drag vs. the S&P 500 index.
- V. **FTSE:** a company co-owned by The Financial Times and the London Stock Exchange that specializes in index calculation.

- W. **FTSE EPRA/NAREIT Global Real Estate Index:** a free-float index designed to track the performance of listed real estate companies and real estate investment trusts worldwide.
- X. **Hard-dollar Fees:** fees or payments paid to brokerage firms in return for their services.
- Y. **HOLDRS:** acronym for Holding Company Depositary Receipts. HOLDRS are EFTs issued by Merrill Lynch & Co., Inc.
- Z. **IAASP:** Investment Accounting Application Service Provider. This represents the outside service provider retained by the Board to provide investment accounting and technology services to the System. See **Exhibit A** for the System's current IAASP.
- AA. **IA:** Investment Accounting.
- BB. **Information Ratio:** a measure of risk-adjusted excess return used to evaluate active management strategies. The information ratio is calculated by dividing a portfolio's excess return by excess risk.
- CC. **Internal Portfolio Manager:** an individual employed by the Board who manages an investment portfolio.
- DD. **Investment Consultant:** a third-party firm retained by the Board to provide advice on various investment issues ranging from general advice to advice on specialty asset classes (real estate or Private Markets). See **Exhibit A** for the System's current Investment Consultants. The System's real estate and Alternative Investment Investment Consultants are hereafter referred to as specialty Investment Consultants.
- EE. **Investment Guidelines:** an outline of policy or conduct expected in the management of an investment portfolio.
- FF. **Investment Office Directors:** includes the Director of Private Markets & Real Estate, the Director of Equities, the Director of External Public Markets, Risk & Compliance, the Director of Fixed Income, and the Director of Trading.
- GG. **Investment Manager:** includes both Internal Portfolio Managers and External Portfolio Managers.
- HH. **IOS:** Investment Office Staff. IOS includes all individuals in the CIO's department.
- II. **iShares:** ETFs issued by Barclays Global Investors.

- JJ. **Lehman Brothers Aggregate Bond Index:** an index of U.S. government securities, mortgage-backed securities, asset-backed securities, and corporate securities to simulate the universe of bonds in the U.S. fixed income market. The maturity of the bonds in the index is over one year.
- KK. **Lehman Brothers Global Aggregate Bond Index:** an index of U.S. and non-U.S. government securities, mortgage-backed securities, asset-backed securities and corporate securities to simulate the universe of bonds in the global fixed income market. The maturity of the bonds in the index is over one year.
- LL. **Lehman Brothers Global High Yield Index:** an index of U.S. and non-U.S. below investment grade fixed income securities.
- MM. **Lehman Brothers Multiverse Index:** a broad-based index that provides a measure of the global fixed income market. The index represents the union of the Lehman Brothers Global Aggregate Bond Index and the Lehman Brothers Global High Yield Index.
- NN. **Lehman Brothers U.S. TIPS Index:** an index of U.S. Treasury Inflation Protection Securities (TIPS) to simulate the universe of U.S. TIPS.
- OO. **Lehman Brothers U.S. Universal Index:** an index that covers U.S. dollar denominated, taxable fixed income securities that are rated either investment grade or below investment grade.
- PP. **Long-term:** in the context of the System, long-term represents perpetuity.
- QQ. **Modern Portfolio Theory (MPT):** theory of trust investment and portfolio management that looks more toward the portfolio as a whole and less toward the prudence of a single investment in the portfolio. MPT assumes that investors: a. use a portfolio approach to evaluate investments; b. are risk-adverse; c. behave rationally; and, d. make unbiased forecasts.
- RR. **MSCI ACW Index ex. U.S.:** acronym for Morgan Stanley Capital International All-Country World Index excluding the United States. It is an index of non-U.S. equity securities used to simulate the universe of stocks in the non-U.S. equity market.
- SS. **NAREIT:** acronym for the National Association of Real Estate Investment Trusts. NAREIT is a trade association that represents U.S. Real Estate Investment Trusts (REITs) and publicly traded real estate companies worldwide.

- TT. **NCREIF Index:** acronym for National Council of Real Estate Investment Fiduciaries Index. It is an index of real estate partnership portfolios used to simulate the universe of real estate partnerships.
- UU. **Outside Service Providers:** External Portfolio Managers and Investment Consultants.
- VV. **Policy Index:** a Benchmark used by the Board to measure the investment performance of the System.
- WW. **Private Markets (formerly Alternative Investments):** Investments in limited partnerships, limited liability companies, and other entities that invest in private debt, private equity, or venture capital.
- XX. **Prudent Expert Standard:** the exercise of that degree of judgment, skill and care under the circumstances then prevailing which persons of prudence, discretion and intelligence who are expert in such matters exercise in the management of their own affairs not in regard to speculation, but in regard to the permanent disposition of the fund, considering the probable income to be derived therefrom as well as the probable safety of their capital.
- YY. **Prudent Investor Standard:** as articulated in the Board’s enabling legislation, the Public School Employees’ Retirement Code, “the exercise of that degree of judgment, skill and care under the circumstances then prevailing which persons of prudence, discretion and intelligence who are familiar with such matters exercise in the management of their own affairs not in regard to speculation, but in regard to the permanent disposition of the fund, considering the probable income to be derived therefrom as well as the probable safety of their capital.” 24 Pa. C.S. §8521(a).

The Prudent Investor Standard requires a trustee to act prudently and with caution, discretion, loyalty, and care but does not restrict the assets in which the Board can invest. Under the Prudent Investor Standard, which recognizes Modern Portfolio Theory, the Board’s investment and management decisions respecting individual assets shall be considered in the context of the portfolio as a whole and as part of an overall investment strategy, and not in isolation. No specific investment or course of action, taken alone, shall be considered inherently prudent or imprudent. This standard recognizes the trade-off between risk and return.

- ZZ. **PTRES:** publicly traded real estate securities.
- AAA. **Securities Lending Program:** an investment program designed to generate incremental income from lending securities to qualified



borrowers who provide collateral in exchange for the right to use the securities.

- BBB. **Soft-dollar Arrangements:** a means of paying brokerage firms for their services through commission revenue, as opposed to through normal payments (Hard-dollar fees).
- CCC. **SPDRs:** acronym for Standard & Poor's Depository Receipts; also commonly known as "spiders." Each share of a spider contains one-tenth of the S&P 500 Index. SPDRs are an ETF.
- DDD. **Staff:** employees of the System.
- EEE. **State Treasurer:** the Treasurer of the Commonwealth of Pennsylvania.
- FFF. **System:** The Pennsylvania Public School Employees' Retirement System.
- GGG. **Tracking Error:** a measure of relative risk that compares a portfolio's returns to an alternative standard the investor has selected, such as a passive index. The tracking error measure incorporates the effects of all active investment decisions and is defined as the volatility or standard deviation of excess returns.
- HHH. **Trading Desk:** represents the group of individuals employed by the Board that generally trades equity securities for investment managers managing U.S. equity portfolios for the Board but can also trade non-U.S. equity securities, futures, options, forwards, etc.
- III. **Unit Investment Trust:** a registered trust in which a fixed portfolio of income-producing securities are purchased and held to maturity.
- JJJ. **Venture Economics Median:** benchmark for Private Markets that represents the median performance of the venture capital/private equity industry listed in the Investment Benchmarks Reports on Venture Capital and Buy-outs produced by Venture Economics.

## **II. Investment Policy Statement**

### **Purpose of Investment Policy Statement**

The purpose of this Investment Policy Statement (the "Policy") is to provide clear guidelines for the management of the assets by or on behalf of the Board. This Policy establishes policies and guidelines for the investment practices of the Board. The Board shall endeavor to review and revise the Policy annually and make changes as necessary. The Policy outlines objectives, goals, restrictions, and responsibilities to assure that:

1. The Board, Staff, Investment Consultants, Investment Managers, and the State Treasurer clearly understand the objectives and policies of the Board and the System;
2. The Investment Managers shall be given guidance and limitations on the investment of the System's assets; and,
3. The Board has a meaningful basis for evaluating the investment performance of individual Investment Managers, as well as for evaluating overall success in meeting its objectives.

The System shall at all times be managed in accordance with all applicable state and federal laws, rules, and regulations.

### **The Board**

The Board was established on July 18, 1917, under the provisions of Pamphlet Law 1043, No. 343. It was most recently established by state law as an independent administrative board of the Commonwealth, which acts as a board of trustees, exercising exclusive control and management of the System, including the investment of its assets. Membership in the System is mandatory for nearly all qualifying public school employees in the Commonwealth of Pennsylvania. The Board administers a governmental cost-share multiple-employer plan that provides retirement allowances and other benefits to members. As part of the Board's function, it has the responsibility for the implementation of investment policy, Asset Allocation, retention of Investment Managers, and ongoing supervision of investment results. The Board is also responsible for establishing policies with respect to fees and commissions for all Investment Consultants, Investment Managers, and agents to the plan assets. The Board has fifteen members including the Commonwealth's Secretary of Education, the State Treasurer, the Executive Director of the Pennsylvania School Boards Association, two members appointed by the Governor, six elected members (three from among the System's certified members, one from among the System's non-certified members, one from among the System's annuitants, and one from among school board members in Pennsylvania), two members from the Senate, and two members from the House of Representatives.

## **Mission of Board**

The Board and the employees of the System serve the members and stakeholders of the System by:

- Prudently investing the assets of the System;
- Maintaining a financially sound System;
- Providing timely and accurate payment of benefits;
- Clearly communicating members' and employers' rights and responsibilities; and
- Effectively managing the resources of the System.

## **Fiduciary Standard**

As fiduciaries, the members of the Board and Staff must act solely in the interests of the members of the System and for the exclusive benefit of the System's members. In performance of their duties, the members of the Board and Staff delegated with investment authority shall be held to the Prudent Investor Standard.

Outside Service Providers shall be held to the Prudent Expert Standard. The Prudent Expert Standard shall be reflected in the System's contracts with Outside Service Providers.

## **Investment Objectives**

The overall objective of the System is to provide benefits to its members through a carefully planned and well-executed investment program.

A. **Return Objectives** – The overall return objective is to realize a return sufficient to achieve funding adequacy on an inflation-adjusted basis. Funding adequacy is achieved when the actuarial market value of assets is at least equal to the System's projected benefit obligations. The System has a return objective of meeting or exceeding the actuarial rate (currently 8.5%) over the long-term. In addition, the Board has the following broad objectives:

1. The assets of the System shall be invested to maximize the returns for the level of risk taken; and,
2. The System shall strive to achieve a return that exceeds the Policy Index.

## B. Risk Objectives

1. The assets of the System shall be diversified to minimize the risk of losses within any one asset class, investment type, industry or sector distribution, maturity date, or geographic location. Failure to do so could seriously impair the System's ability to achieve its funding and long-term investment goals and objectives; and,
2. The System's assets shall be invested so that the probability of investment losses (as measured by the Policy Index) in excess of 12% in any one year is no greater than 2.5% (or two standard deviations below the expected return).

## C. Constraints

1. The assets of the System shall maintain adequate liquidity to meet required benefit payments to the System's beneficiaries.
2. The System's assets shall be invested in a manner that is consistent with the System's long-term investment horizon.
3. As a tax-exempt investor, the System's assets may be invested without distinction between returns generated from income and returns generated from capital gains.

## Identification of Duties and Investment Responsibilities

The Board relies on IOS, IA, and Outside Service Providers in executing its investment functions. Each entity's role as fiduciary are identified below to ensure clear lines of communication, operational efficiency, and accountability in all aspects of the System's operation.

- **The Board:** The Board has the responsibility of managing the investment process and setting the Asset Allocation. The Board, through the Finance Committee with the assistance of Staff, contracts with External Portfolio Managers and Investment Consultants, monitors the performance of investments; ensures funds are invested in accordance with Board policies; studies, recommends, and implements policy and operational procedures that will enhance the investment program of the System; and ensures that proper internal controls are developed to safeguard the assets of the System.
- **IOS:** IOS is responsible for the day-to-day administration of the investment operations of the System in accordance with Board policies as well as for reporting to the Board. Major items included in the day-to-day administration are working with and monitoring the performance of the outside service providers; developing, implementing, and monitoring the Asset Allocation plan; direct

investment in and trading of securities; recommendation and oversight of Investment Managers; reporting of investment results, including both performance and assets held; oversight of the proxy voting process; and governmental and regulatory reporting.

- **IA:** IA is responsible for processing, monitoring, and recording all investment transactions as well as supporting the day-to-day administration of the investment operations of the System in accordance with Board policies. IA prepares daily, monthly and quarterly reports and analysis for IOS and the Board on cash management, the net asset value of the System, Asset Allocation, Investment Manager fees and securities class action recoveries. IA is also responsible for various regulatory and government reporting of investments, including the System's Comprehensive Annual Financial Report. In addition, IA is the primary liaison with the State Treasurer's office on daily cash movement and treasury operations, oversees the Custodian Bank and the IAASP and interfaces with the Investment Managers, brokers and Investment Consultants on investment accounting and operational issues.
- **Investment Consultants:** Investment Consultants shall have the responsibility of assisting the Board and Staff in managing the investment process. The Board shall determine their specific responsibilities, which shall be set forth in their respective contracts with the Board.
- **State Treasurer:** The State Treasurer is the legal custodian of not only the System's assets but also those of the entire Commonwealth. The State Treasurer has subcontracted the custodian function to the Custodian Bank for the Commonwealth, including the System. The Custodian Bank holds all cash and securities (except for those held in partnerships, commingled funds, mutual funds, etc.), and regularly accounts for these holdings to the System.
- **Investment Managers:** All External Investment Managers shall be retained pursuant to written contracts. Investment Managers shall construct and manage investment portfolios consistent with the investment philosophy and disciplines for which the Board retained them and their specific investment guidelines, all of which shall be set forth in their Investment Objectives and Guidelines with the Board. They shall buy and sell securities and modify the asset mix within their stated guidelines. The guidelines shall be subject to periodic amendment at the discretion of the Board and IOS. The Board believes that investment decisions are best made when not restricted by excessive procedure. Therefore, full discretion shall be delegated to the Investment Managers to carry out investment policy within their stated guidelines, as amended. Investment Managers shall comply with the specific limitations, guidelines, and philosophies stated herein and within the Addendum(s) to the Investment Objectives and Guidelines assigned to them, or as expressed in written amendments thereto. Investment Managers are expected to communicate, in writing, any developments that may affect the System's portfolio to Staff within five business

days of occurrence. Examples of such events include, but are not limited to, the following:

- A significant change in the Investment Manager's investment philosophy;
- A change in the ownership structure of the firm;
- A loss of one or more key portfolio management personnel; and/or,
- Any occurrence that might adversely impact the management, professionalism, integrity, or financial position of the firm.

### **Asset Allocation**

The Board believes that the level of risk assumed by the System is largely determined by the Board's strategic Asset Allocation plan. The Board, in determining its long-term Asset Allocation, shall take the following factors into consideration:

- The System's investment time horizon;
- The demographics of the plan participants and beneficiaries;
- The cash flow requirements of the System;
- The actuarial assumptions approved by the Board;
- The funded status of the System;
- The Board's willingness and ability to take risk; and,
- The employers' (Commonwealth and school districts) financial strength.

In establishing the Asset Allocation for the System, the Board considers capital market expectations for expected return, volatility, and asset class correlations as prepared by its general Investment Consultant. The current long-term, top-down Asset Allocation targets of the Board, based on the market value of the System's assets, is attached at **Exhibit B**.

Monthly, IA will prepare the Moneyline Report of Investment Asset Values and post on the Board's secure intranet web site. The Moneyline Report will present the month-end Asset Allocation of the System as compared to the Asset Allocation plan targets approved by the Board.

### **Policy Index**

The current Policy Index is attached at **Exhibit C**.

### **Asset Class Rebalancing**

The Board is responsible for the System's Asset Allocation decisions and will meet to review target allocations at least annually or more frequently as needed based on market conditions. Until such time as the Board changes allocations, it will be necessary to periodically rebalance the portfolio as a result of market value fluctuations. The Board delegates to the CIO the duty of implementing

such rebalancing. IOS will review the Asset Allocation on a monthly basis. Any asset class that falls outside the policy ranges described in **Exhibit B** will be rebalanced to within the policy range within a reasonable and prudent period of time by the CIO. The CIO has the authority to tactically allocate between asset classes as long as the amount allocated to each asset class is within the policy ranges described in **Exhibit B**.

Asset Allocation rebalancing may be accomplished by using the cash markets or through the use of Derivative securities. Derivative securities may only be used to implement temporary adjustments. When feasible, index funds will be used to facilitate rebalancing to minimize the transition time frame and costs to implement. Any account may be increased or decreased to achieve the rebalancing objective based on the judgment of the CIO. When a rebalancing is required, consideration will be given to the unique characteristics of each asset class, the degree of over/underweight, liquidity characteristics, current market conditions, and any other relevant considerations to ensure prudence and care.

The purpose of this structured rebalancing policy is to provide a disciplined approach to Asset Allocation. All rebalancings shall be reported to the Board at its next scheduled meeting.

### **Investment Structure**

Annually, the general Investment Consultant shall provide the Board with the investment structure of the System. The investment structure includes, among other things, the Investment Managers approved by the Board as well as the pro forma targets as a percentage of the total fund by Investment Manager. These target percentages represent the portion of the total fund allocated to each Investment Manager for investment management. IOS shall, when able and within a reasonable period of time, implement the investment structure within the target ranges noted in **Exhibit D**. The CIO shall have discretion in the timing of such implementation and have discretion in implementing changes, taking into account transactions costs and liquidity.

IOS shall endeavor to invest any underweight in private real estate in public market real estate securities until such a time as the money is allocated to and invested by a private real estate fund. In addition, IOS shall invest any underweight in private markets (private debt, private equity, and venture capital), in public market equities until the money is allocated to and invested by an alternative investment fund. Should either private real estate or private markets be overweight versus target, then IOS shall reduce the allocation to the public market real estate securities/public market equities allocation.

### **Index Portfolio Rebalancing**

Throughout the year, the index portfolios need to rebalance positions to minimize the tracking error of the portfolios. At times, rebalancing may lead to inefficient buying and selling of securities. To minimize the costs associated with rebalancing the portfolios, the CIO shall have discretion to fund the internally managed index accounts, as necessary, with additional cash consistent with the Asset Allocation.

## **Cash**

The System currently has cash outflows (primarily benefit payments) in excess of cash inflows (primarily contributions and investment income received). In addition, Frictional Cash is minimized in the System through the commingling of the cash in various investment portfolios and reallocation of excess cash through the Asset Allocation plan. Therefore, there will be various points in time where the CIO will need to increase cash through allocation reductions to meet the liquidity needs of the System. As such, the CIO shall have the discretion to raise cash from any of the public market equity or fixed income portfolios as he considers prudent. The CIO shall consider the current positioning of the Asset Allocation, liquidity, cost, etc. in determining where to raise cash.

## **Allocation Approval Process**

For internal control purposes, all Investment Manager fundings, including but not limited to those for new Investment Managers, private market investment managers' capital calls, index portfolio rebalancing, termination of Investment Managers, and cash flow related activities initiated by the CIO, will be reviewed, audited for compliance with the Investment Policy Statement, Objectives, and Guidelines, and approved by IA. Once approved, IA will process and execute all allocations with the State Treasurer and its Custodian Bank. Monthly, the IA will prepare and post on the Board's secure intranet web site a report of allocation changes that will detail each allocation increase and decrease.

## **Selection of Investment Managers**

The Board delegates to IOS the authority to conduct Investment Manager searches with the assistance of the appropriate Investment Consultant. All Investment Managers, excluding Developmental Fund Investment Managers, shall be approved by the Board prior to execution of a contract. The following are the selection procedures for public market Investment Managers, private market Investment Managers (partnerships), and Developmental Fund Investment Managers.

### ***Public Markets excluding the Developmental Fund***



A search for a public market equity, fixed income, or real estate Investment Manager is not conducted until there is a need for an Investment Manager. The following are potential reasons for an Investment Manager search:

- Termination of an existing Investment Manager due to organizational/personnel changes, change in investment process/philosophy, or poor performance;
- Expansion of an allocation to an asset class or,
- Addition of a new asset class.

The following are the steps taken to conduct the search:

- The DEPM shall be responsible for public market Investment Manager searches.
- IOS shall leverage the appropriate Investment Consultant's research to develop a list of potential Investment Managers to interview for potential inclusion in the System in those areas where sufficient data exists. At times, IOS and the appropriate Investment Consultant will use other means of searching for Investment Managers to meet the needs of the System because a comprehensive database of Investment Managers may not exist (i.e., portable alpha Investment Managers, commodity Investment Managers, etc.).
- IOS and the appropriate Investment Consultant shall review an initial list of Investment Managers. The list shall be narrowed to a manageable number based on the number of Investment Managers needed (short list).
- The Investment Consultant shall prepare a presentation book including a profile of each Investment Manager on the short list, historical performance, the appropriate Investment Consultant's ranking or score, if any, assets under management of the Firm and product, inception date of the firm and product, style/size comparison (if applicable), and correlations of excess returns vs. other potential Investment Managers and existing Investment Managers in the specific mandate.
- Investment Managers on the short list shall be interviewed by IOS (CIO, DEPM, Compliance Officer, and normally at least one of the other Investment Office Directors based on the mandate) and the appropriate Investment Consultant. Based on the qualitative and quantitative information gathered prior to and during the interview, IOS and the appropriate Investment Consultant come to a consensus as to which Investment Manager(s) best compliments the System's investment program. The factors which may be considered include, but not be limited to:
  - Organizational stability
  - Investment approach and process
  - Competence of staff
  - Expected returns and correlations
  - Integrity

- Quality of reporting
- The DEPM shall enter into fee and contract negotiations with each selected Investment Manager. If DEPM is unable to negotiate an acceptable contract, the next best choice is selected, and this process continues until the Investment Manager and the System come to an agreement on the terms. Once an agreement is reached, the selected Investment Manager(s) is recommended to the Finance Committee and Board for approval within the investment structure.

***Private Markets, including Private Debt, Private Equity, Venture Capital and Real Estate***

IOS monitors new private market funds coming to the market. The following steps are taken to hire a new Private Market Investment Manager:

- IOS is contacted regarding new fund or receives a referral from the specialty Investment Consultant.
- IOS will perform an initial screening to evaluate the investment opportunity, including:
  - Size of fund
  - Strategy of fund
  - Fund's deal terms
- If IOS or the specialty Investment Consultant wishes to continue the evaluation, IOS shall arrange to meet with the general partner of the fund under consideration.
- If IOS wants to move forward with more in-depth due diligence, the general partner may be required to sign a Model Letter of Understanding (**Exhibit E**) that outlines the following:
  - Specific deal terms required by the Finance Committee;
  - Indemnification contract language; and,
  - Sample side letter language.
- The prospective general partner shall also complete an investment questionnaire for IOS and the specialty Investment Consultant that includes:
  - Performance history of the organization and partners
  - Fund strategy
  - History of the organization and partners
  - References
- The prospective general partner shall also meet with the appropriate specialty Investment Consultant.
- Following both meetings, IOS and the specialty Investment Consultant shall make a determination about whether to proceed.
- If it is decided to proceed, then (1) the specialty Investment Consultant shall perform detailed due diligence into the prospective fund, (2) IOS may have a follow-up meeting with the general partner, and (3) IOS will

complete its due diligence, including a meeting at the general partner's office.

- The goal of the due diligence process is to determine whether to recommend that the System invest in the prospective fund based on the composition of the investment team (including ethical evaluation), verification of past performance, analysis of the process, style, strategy, etc. All factors evaluated will be used in assessing the potential strengths and weaknesses of the prospective fund.
- If IOS decides to invest in the prospective fund, then DPMRE enters contract negotiations with the general partner.
- Assuming acceptable terms are agreed upon, DPMRE will make a presentation to the Finance Committee. The Finance Committee and the Board are required to approve the investment prior to entering into a contract with the prospective fund.

### ***Developmental Fund***

The Developmental Fund is administered internally by the DFM. The maximum number of Investment Managers permitted in the Developmental Fund program at any one time is 20. The Developmental Fund has a target allocation of 1.5% of the market value of the System with a policy range of 0.0% to 2.0% of the market value of the System. A Developmental Fund Investment Manager's objectives will determine where the Investment Manager is funded from and included in the overall Asset Allocation of the System. The Developmental Fund Program Criteria and Guidelines have been approved by the Board in a separate document entitled "Developmental Fund Policy of The Commonwealth of Pennsylvania Public School Employees' Retirement System" (**Exhibit F**).

The DFM is responsible for searching for Investment Managers that meet the following criteria:

- Firm must be headquartered or incorporated within the Commonwealth; or,
- The firm must be certified by the Bureau of Minority and Women Business Opportunities as a minority or women owned investment management firm.

Firms meeting one of the aforementioned criteria must then also have a three-year or longer historical performance record verifiable by at least one Investment Consultant or accounting firm in accordance with CFA Institute standards. The firm must have at least three distinctly different clients, must have a minimum of \$45 million and no more than \$1.5 billion of total assets under management to be hired and no more than \$3 billion of total assets under management to remain in the program, and at no time can the System ever comprise more than 25% of the assets of any one portfolio.

Prospective firms are brought to the attention of the DFM through other institutional investors, financial publications, word-of-mouth, contact directly by the Investment Manager, or the results of screening a database. The DFM will start the due diligence process on firms that meet the System's required characteristics and qualifications as follows:

- Contact the Investment Manager to have it give a presentation of its product;
- Evaluate prospective Investment Manager based on philosophy, methodology, past performance, ethical standards; and,
- Perform an on-site visit at the Investment Manager's place of business.

The DFM will, based upon the due diligence work, recommend hiring one or more Investment Managers. This recommendation is put into writing and must be approved by both the DPMRE and the CIO. Upon approval, a contract is negotiated and the Investment Manager is funded with an initial allocation of \$15 million. The Investment Manager is then eligible for two additional fundings of \$10 million each based on satisfactory performance.

Prospective Investment Managers are continually monitored by the DFM for future investment consideration.

### **Termination of Investment Managers**

The CIO, after receiving concurrence from the Executive Director and the Chair of the Finance Committee and notifying the Board, has authority to terminate an Investment Manager, except a Developmental Fund Investment Manager, for any reason, including, but not limited to, poor performance, personnel changes, organizational changes, deviation from their investment style, and compliance violations. Notwithstanding the preceding, any individual Board member has the right to request to have the termination decision listed on the agenda of the next scheduled Finance Committee meeting. Pending said Finance Committee meeting, no action shall be taken by the CIO to terminate the Investment Manager. The CIO shall inform the Board of the status of the termination at the next scheduled Board meeting. Upon the termination of any Investment Manager, the CIO has the authority to reinvest the proceeds from the terminated Investment Manager with any remaining Investment Manager(s) previously approved by the Board and/or keep the proceeds in the System's cash management account consistent with the Asset Allocation.

Developmental Fund Investment Managers may be terminated for any reason, including, but not limited to, poor performance, personnel changes, organizational changes, deviation from their investment style, and compliance violations. In addition, Developmental Fund Investment Managers whose assets under management exceed \$3 billion are no longer eligible for participation in the Developmental Fund program and must either be terminated or, with the approval of the DEPM, CIO, Finance Committee, Board, and General Investment Consultant

may be transferred out of the Developmental Fund program to the main investment program. The DFM must receive approval to terminate a Developmental Fund Investment Manager from the DPMRE, the CIO, and the Executive Director.

### **Securities Lending Program**

The State Treasurer has entered into a contract with the Custodian Bank to manage a Securities Lending Program on behalf of the Commonwealth. The Board approves participation in the Custodian Bank's Securities Lending Program subject to the Board approved portfolio specific guidelines, Addendum Z - Securities Lending Objectives and Guidelines.

### **III. Investment Manager Objectives and Guidelines**

The following represent general portfolio guidelines that are applicable to all Investment Manager separate account portfolios.

#### **Adherence to Investment Style**

Each Investment Manager is expected to adhere to the investment philosophy and style that was presented to the Board, IOS, and Investment Consultant at the time of its hiring and as set forth in its contract with the Board.

#### **Measurement Process**

##### *Passive Investment Managers*

Each portfolio shall be measured on a total return basis (yield plus appreciation). On a one-year and three-year annualized rolling return basis, results will be judged, net of all manager fees and transaction costs, versus a pre-established performance band based on the liquidity, volatility, and difficulty in replicating of the benchmark assigned.

##### *Active Investment Managers*

Each portfolio shall be measured on a total return basis (yield plus appreciation). On a one-year and three-year annualized rolling return basis, results will be judged as follows, net of all manager fees and transaction costs:

- A. Relative performance versus a relevant peer Investment Manager universe selected by IOS:
- |                     |                             |
|---------------------|-----------------------------|
| 1. Median and above | Acceptable                  |
| 2. Below median     | Unacceptable; Watch Closely |
- B. Information Ratio (excess return/excess risk vs. the Benchmark assigned to the Investment Manager) as follows:
- |   |                             |
|---|-----------------------------|
| 1. Information Ratio $\geq$ assigned level <sup>1</sup> | Acceptable                  |
| 2. Information Ratio $<$ assigned level <sup>1</sup>    | Unacceptable; Watch Closely |

Quarterly performance shall be evaluated to monitor progress toward attainment of these goals. It is understood that there are likely to be short-term periods during which performance deviates from market indexes. During such times, greater emphasis shall be placed on performance comparisons with Investment Managers employing similar styles. The IOS, the CIO, and the Investment Consultant shall monitor firms experiencing poor short-term performance or disruption at the organizational level. These include changes of ownership, significant personnel changes and substantial deviation from their investment style.

**Interest, Dividend, and Other Miscellaneous Income Earned**

Interest, dividend, and other miscellaneous income earned (“Income Sweep”) each month by the Investment Manager will be swept from each account one month and one business day after the month in which it was earned (for example, income earned in December will be swept from the accounts on the first business day in February). The amount to be swept as determined by the Custodian Bank monthly through the reconciliation process between the Custodian Bank and/or the System is reviewed and approved by IA. The Investment Managers shall be responsible for having sufficient cash available to meet the Income Sweep requirements. The CIO has discretion to waive this provision for any Investment Manager.

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<sup>1</sup> The assigned level will be provided in the addendum to the guidelines for each mandate.

## **Investment Management Fees**

Investment management fees shall be submitted to the System on a quarterly basis. Fees will be paid directly out of the Investment Manager's account as administered by IA. Investment Managers are responsible for having sufficient cash available to cover the amount of the quarterly investment management fee. The CIO shall have discretion to waive this provision for any Investment Manager. On a quarterly basis, IA will prepare a report of investment management fees to be posted on the Board's secure intranet web site.

## **Brokerage Commissions**

### *Equity Investment Managers*

Brokerage commissions are a plan asset and, as such, shall be monitored by the System. The Investment Managers are obligated to seek best execution on all trades.

Investment Managers trading U.S. equities shall be required to execute trades through the System's Trading Desk unless otherwise approved by the CIO.

U.S. equity Investment Managers not trading through the System's Trading Desk and non-U.S. equity Investment Managers shall be required to participate in the System's commission recapture program. The System has retained a Commission Recapture Agent to manage this program and the Investment Managers are required to send monthly reports to the Commission Recapture Agent indicating the commissions directed to each broker, including non-designated brokers. Best efforts must be made to execute trades through commission recapture brokers for initial and subsequent fundings and partial liquidations. All commissions generated through the System's approved commission recapture brokers are considered to be directed trades and should be so communicated by the Investment Manager to the broker.

Commissions recaptured by the System shall be remitted to the restricted revenue account held by the State Treasurer on behalf of the System. The monies in this account shall be used to support the investment operations of the System. All expenditures from the account shall follow the rules established for any other expenditure of the System.

The Investment Managers are permitted to enter into Soft-dollar Arrangements for commissions not executed through the System's Trading Desk or through the System's approved commission recapture brokers provided that:

- Such arrangements are consistent with applicable law and best execution obligations;

- All amounts paid for brokerage and related services are reasonable; and,
- The Investment Manager submits an annual report to the System within six weeks of the end of each calendar year that contains:
  1. A list of each soft dollar broker with which the Investment Manager executes trades on behalf of the System and, for each such broker, the amount of soft dollars that have accrued to the Investment Manager as a result of trading activity on behalf of the System;
  2. An item-by-item listing of the expenditure of said soft dollars, with the cost associated with each expenditure;
  3. A description of the manner in which the cost of each such expenditure was allocated to the System; and,
  4. An explanation of how the System benefited for each such expenditure.

### *Fixed Income Investment Managers*

Fixed income Investment Managers shall use their best efforts to execute trades and all new issue designations with the System's Commission Recapture Agent. National Association of Securities Dealers' rule 2740, "Selling Concessions, Discounts, and Other Allowances," regarding new issue designations preclude the remittance of selling concessions recaptured to be remitted to the System. Those selling concessions, however, may be used to pay for qualified investment research.

### **Proxies**

All proxies shall be voted by the System in accordance with the Board's Domestic and International Proxy Voting Guidelines. Should the Investment Manager have a strongly held position on specific proxy issues as they relate to holdings in the portfolio managed by it, the Investment Manager should state its positions in writing to the CIO for consideration.

The Board, through the Corporate Governance Committee of the Board, has adopted a separate Domestic Proxy Voting Policy and a separate International Proxy Voting Policy. These policies are carried out by a third-party proxy-voting agent that has been retained by the Board and are located at the following web link: [www.psers.state.pa.us/invest/invest.htm](http://www.psers.state.pa.us/invest/invest.htm).

### **Class Actions**

The Board or its appointed delegate shall be responsible for the filing of all necessary papers or documentation regarding class action settlements proposed or received as a result of holdings in the System. Investment Managers shall promptly forward any papers or documentation received by it to the Board regarding class actions.



## **Mutual/Commingled Funds and Unit Investment Trusts**

Mutual funds (both closed and open-ended), Commingled Funds, Unit Investment Trusts, ETFs, or any equivalent fund type funds are prohibited investment vehicles without the written permission of the CIO.

## **Market-Driven Breaches**

The System recognizes that the portfolio will always be subject to fluctuations in market value. Market-driven breaches of the guidelines (breaches that occur due to market fluctuations) shall not be considered a violation of the guidelines as long as the Investment Manager corrects these breaches within 10 business days of the breach (unless an extended period of time is granted elsewhere in the guidelines and/or written permission is received from the CIO providing an extended period of time). Active breaches (breaches that occur due to purchase and sale activity) shall be considered a violation of the guidelines and must be corrected as soon as prudently possible. Consistent patterns of active breaches may be cause for termination.

## **Insurance**

External Investment Managers are required to carry both errors and omissions (E&O) insurance and fidelity bond coverage. The insurer from which the Investment Manager obtains coverage must have a financial strength rating of A- or better and a financial size category rating of VII or higher, both by A.M. Best. The fidelity bond must name the Board as either a loss-payee or additional insured party. Both the E&O coverage and fidelity bond must provide that the Board be given at least 30 days notice prior to any cancellation or policy change. Insurance coverage may be in the name of the Investment Manager's parent organization as long as the Investment Manager is named in that policy or bond as an insured party.

The Investment Manager is required to maintain E&O coverage amounting to at least 1 percent of assets under management for the System. The Investment Manager must maintain a fidelity bond coverage amounting to at least 0.5 percent of cumulative assets under management for the System. The minimum amount of E&O and fidelity bond coverage shall be \$500,000. The maximum deductible on both the Errors and Omissions coverage and the Fidelity Bond must be either: (a) no greater than \$500,000 if the Investment Manager has less than \$1 billion in assets under management and no greater than \$1 million if the Investment Manager has \$1 billion or more in assets under management, or (b) no greater than 10 percent of the Investment Manager's retained earnings (equity) as disclosed in the Investment Manager's annual audited balance sheet which must be provided to the Board annually in a timely fashion.

## **Derivatives**

Unless written permission is obtained from the CIO or unless otherwise specified in the portfolio specific guidelines, derivative investments, including but not limited to, forwards, futures, interest only and principal only strips, options, structured notes, swaps, etc. are prohibited.

## **Communications**

Written and/or oral reports must be supplied by the Investment Manager, in sufficient detail and with supporting commentary, so the CIO and DEPM are apprised of status and any changes in philosophy or investment strategy. Periodic meetings shall be held with the Investment Manager to discuss performance results, economic outlook, investment strategy, organizational changes and other pertinent matters.

The Board requires continual awareness of the System's activity and position, both absolute and relative. To accomplish this, the following shall be provided by the public market Investment Managers:

### **A. Promptly -**

1. When requested by the Staff - a complete listing of all holdings, pending trades, transaction history and any additional related information.
2. Notification to the CIO, the DEPM, and the Compliance Officer of any compliance exceptions as they relate to these policies and applicable amendments.
3. Notification to the CIO, DEPM, and the Compliance Officer of any material personnel or organizational changes that could affect the management of the System's portfolio.

### **B. Daily - To the Custodian Bank, IA, and the IAASP:**

1. On a daily basis all trades, including foreign currency exchange transactions, must be sent via e-mail to IA and IAASP in a Microsoft Excel-readable formatted file. The trade file should include, but not be limited to, the following: Custodian Account Number, Buy/Sell indicator, Broker Identification Code, Broker Name, Trade Date, Settle Date, Ticker, CUSIP, Security Description, Shares, Price, Principal, Commission, Fees, and Net Amount (all monetary amounts to be provided in base and local currency).

**C. On an as needed basis** - information for the State Treasurer's staff to perform their pre-audit function.

**D. Monthly** - To the Investment Consultant, CIO, DEPM, Compliance Officer, and IA:

1. End of month valuations in accordance with the System's requested format or, if PSERS does not request a specific format, the Investment Manager's usual format, containing cost and market valuations by security (including FX forward and spot positions), holdings by sector segmentation, transaction summary register (purchases, sales, dividends/interest, other distributions/receipts), and holdings by country, with cost and market valuation in local currency and in U.S. dollar terms. These reports shall be in electronic form (i.e. Microsoft Excel, Adobe Acrobat files, etc.) and shall be sent via e-mail to the System and the System's general or designated Investment Consultant unless written permission is received from the CIO to send reports other than by e-mail.

**E. Monthly** - To the DEPM, Compliance Officer, and IA:

1. Total commissions incurred by broker, and segregated by those in the Commission Recapture Program and those not in the Commission Recapture Program.
2. Performance reports for the month, quarter-to-date, year-to-date, rolling one-year, rolling three-year, and portfolio-to-date (since inception) as well as the benchmark performance figures for each of those periods. Information is to be sent via e-mail to a designated Internet address within five business days from the end of each month.

**F. Monthly** - To Custodian Bank, IA, and IAASP:

1. Each Investment Manager is required to complete a month-end reconciliation of its account balance to the balance per the Custodian Bank. A reconciliation template in the form of a Microsoft Excel spreadsheet shall be sent via e-mail from the Custodian Bank not later than the seventh business day of the following month. The Investment Manager is required to transmit its reconciliation via e-mail to the Custodian Bank and IA by the third business day (not later than the tenth business day of the following month) following receipt of the reconciliation template. The Custodian Bank in those cases where there are variances

between the Investment Manager and the Custodian Bank above a certain threshold and the Custodian Bank is deemed to be incorrect will issue a letter restating the month-end net asset value of the account. Restated net asset values will be used for performance and billing purposes.

2. The final or closed account holdings and amounts, including cash and pending trades, must be sent via e-mail to IA and IAASP in a Microsoft Excel-readable formatted file. The holdings spreadsheet should include at least the following headings and information: custodian account number, CUSIP, security description, shares, base cost, local cost, base market value, and local market value.

**G. Quarterly** - To the DEPM and Compliance Officer:

1. Provide written confirmation of adherence to these Investment Objectives and Guidelines in the format provided by the System within 30 days after the end of each calendar quarter. Consistent patterns of failing to complete the compliance certifications within 30 days after the end of each calendar quarter may be cause for termination.
2. Provide a detailed attribution of returns for the portfolio for the previous quarter and year versus the established benchmark for the portfolio within 30 days after the end of each calendar quarter.
3. Provide a quarterly report showing the dispersion of the System's returns versus a representative composite return for the quarter, rolling one-year, rolling three-year, and since inception in a format provided by the DEPM within 45 days after the end of each calendar quarter.

**H. Annually** - The portfolio manager is expected to visit IOS in Harrisburg to provide an update on the firm, provide a portfolio overview, staff changes, etc.

**I. Other** - To the Investment Consultant, CIO, and DEPM:

Immediate telephone and/or letter advice should be forthcoming from the Investment Manager when information of an important nature, such as a change in ownership of the advisor, a change in the portfolio manager(s) managing the System's portfolio, or unusual market activity (oil embargo, monetary crisis, etc.) that is causing, or may cause, material impact on the System.

## **Portfolio Specific Guidelines**

The portfolio specific guidelines are included as an addendum to this document. The following are the various addendums (by letter and by name), one of which will be assigned to each separate account portfolio or program:

### **U.S. Equity Guidelines**

- A U.S. STYLE-ORIENTED LARGE CAP EQUITIES
- B U.S. EXTENDED MARKET EQUITIES
- C U.S. STYLE-ORIENTED SMALL CAP EQUITIES
- C1 U.S. MICRO CAP EQUITIES
- D ENHANCED S&P 500 INDEX FUND
- E INTERNALLY MANAGED INDEXED EQUITY PORTFOLIOS
- E1 INTERNALLY MANAGED EQUITY SUBSTITUTION PROGRAM
- E2 EQUITY REBALANCING PROGRAM
- F EQUITY OPTION PROGRAM – INCREMENTAL RETURN
- G ENHANCED U.S. MID CAP EQUITIES

### **Commodity Guidelines**

- H FULL DISCRETION COMMODITY PROGRAM
- H1 ENHANCED COMMODITY INDEX PROGRAM

### **U.S. Fixed Income Guidelines**

- I U.S. CORE PLUS FIXED INCOME
- J FIXED INCOME REBALANCING PROGRAM
- K U.S. HIGH YIELD FIXED INCOME PORTFOLIOS
- L TREASURY INFLATION PROTECTION SECURITIES PORTFOLIO

### **Non-U.S. Equity Guidelines**

- M NON-U.S. EQUITIES
- N NON-U.S. SMALL CAP EQUITIES
- O EMERGING MARKETS EQUITIES

### **Currency Guidelines**

- P ACTIVE CURRENCY HEDGING OVERLAY PROGRAM
- P1 ACTIVE CURRENCY PROGRAM

### **Global Fixed Income Guidelines**

- Q GLOBAL CORE PLUS FIXED INCOME

## **Pennsylvania Mortgage Program Guidelines**

- R PENNSYLVANIA MORTGAGE PROGRAM GUIDELINES & PROCEDURES

## **Real Estate Guidelines – Private and Public**

- S OPEN-END REAL ESTATE FUND INVESTMENTS
- T U.S. PUBLICLY TRADED REAL ESTATE SECURITIES
- T1 NON-U.S. PUBLICLY TRADED REAL ESTATE SECURITIES
- T2 GLOBAL PUBLICLY TRADED REAL ESTATE SECURITIES
- U CLOSED-END OPPORTUNISTIC AND VALUE-ADDED REAL ESTATE INVESTMENTS
- V REAL ESTATE PROGRAM
- W FARMLAND INVESTMENT PROGRAM

## **Alternative Investment Guidelines**

- X PRIVATE INVESTMENT AND VENTURE CAPITAL POLICY
- X1 PRIVATE DEBT POLICY

## **Short-Term Investment Pool Guidelines**

- Y SHORT-TERM INVESTMENT POOL
- Y1 INTERNALLY MANAGED LIBOR-PLUS SHORT TERM INVESTMENT POOL

## **Securities Lending Guidelines**

- Z SECURITIES LENDING

## **Investment Policies Deviations**

This Policy is intended to state the position of the Board concerning investments in the various approved asset classes. While a prudent investor could adopt policies that would subject the fund to more risk, the policies adopted herein are statements of the level of risk that the Board is currently willing to accept consistent with its fiduciary obligation to support the present and future pension obligations of the System.

The following procedures should be employed when there is a variation between adopted policies and actual practice:

1. When an Investment Manager is given permission to invest in a particular manner pursuant to an exception to the policies granted by the CIO as explicitly permitted in the

guidelines, that permission shall be given in writing to the Investment Manager and reported to the Finance Committee monthly by way of posting on the Board's secure intranet web site. Notification is provided monthly to the Board regarding the availability of these reports.

2. When an Investment Manager violates a policy, the CIO (in the interest of preserving capital) may give the Investment Manager reasonable time to liquidate the position that is violative of the policy or the CIO may allow an exception to the policy. When appropriate, the Investment Manager shall be notified in writing of its liability in the event of a loss. In all cases, the Finance Committee shall be notified at its next meeting of any material violation and the action taken by the CIO. Exceptions to the guidelines permitted by the CIO shall be reported to the Finance Committee monthly via posting on the Board's secure intranet web site. Notification is provided monthly to the Board regarding the availability of these reports.
3. When an Investment Manager wishes (a) to invest in a manner inconsistent with specific Board policies, (b) the investment is not covered by paragraph (1) and (c) the CIO believes that under the circumstances the proposed investment is appropriate notwithstanding the Board policies, the CIO shall grant a waiver of Board policy and report material waivers to the Finance Committee at its next meeting. All waivers granted shall be reported to the Finance Committee monthly via posting on the Board's secure intranet web site. Notification is provided monthly to the Board regarding the availability of these reports.
4. The Board may waive any of its limitations on any investments if the need for a waiver is specifically referred to in the materials presented to the Finance Committee and the Board and a discussion of that waiver is included in the minutes of the Finance Committee and the Board.

Monthly, the CIO shall notify the Finance Committee and the Board of the waivers then currently in effect and the waivers issued during the preceding month through a posting on the Board's secure intranet web site.

## **Review and Amendments**

The Board shall review Investment Manager compliance with this Policy and any addendum related to the Investment Manager's mandate plus any amendments thereto.

In the application and implementation of the Investment Policy Statement, Objectives, and Guidelines, the CIO has the authority to interpret the guidelines to meet individual portfolio needs and to determine the appropriateness of any investment. On material policy issues and amounts, the CIO and/or the Executive Director, in conjunction with the Chair of the Finance Committee and/or Chair of the Board, will evaluate and determine the appropriateness of any investment. All interpretations of material policy issues and dollar amounts will be reported to the Finance Committee at the next regularly scheduled meeting.

If at any time the Investment Manager believes that the objectives cannot be met, or the guidelines constrict performance, the CIO should be notified in writing. The Investment Manager shall be encouraged to suggest changes in these guidelines as necessary. By signature the Investment Manager shall agree to these Investment Policy Statement, Objectives, and Guidelines and shall perform in accordance therewith.



## **Exhibit A**

The following is a list of current professional service providers to the System.

|  |  |
|--|--|
| Private Markets, Real Estate, and<br>External Portfolio Managers | see <a href="http://www.psers.state.pa.us/invest/invest.htm">www.psers.state.pa.us/invest/invest.htm</a><br>for "Roster of Investment Managers,<br>Advisors, and Partnerships" |
| Private Markets<br>Investment Consultant                         | Portfolio Advisors, LLC  |
| Commission Recapture Agent                                       | Lynch, Jones & Ryan  |
| Custodian Bank   | Mellon Bank, N.A.  |
| IAASP  | Financial Control Systems, Inc.  |
| General Investment Consultant                                    | Wilshire Associates Inc.   |
| Proxy Voting Agent   | Glass Lewis & Co.  |
| Real Estate Investment<br>Consultant                             | Courtland Partners, Ltd.   |

## Exhibit B

The current long-term, top-down Asset Allocation targets of the Board, based on the market value of the System's assets:

| <u>ASSET CLASS</u>   | <u>SUB-CLASS<br/>OBJECTIVE</u> | <u>OBJECTIVE</u>     | <u>POLICY<br/>RANGE</u> |
|--|--------------------------------|----------------------|-------------------------|
| <b>Public Market U.S. Equity Exposure</b>                        |                                |                      |                         |
| Large Cap  | 23.2%                          |                      | 19.2% - 27.2%           |
| SMID Cap   | 5.2%                           |                      | 4.3% - 6.1%             |
| Micro Cap  | <u>0.6%</u>                    |                      | 0.4% - 0.8%             |
| <b>Total Public Market U.S. Equity Exposure<sup>2</sup></b>      |                                | <b>29.0%</b>         | <b>24.0% - 34.0%</b>    |
| <b>Public Market Non-U.S. Equity Exposure</b>                    |                                |                      |                         |
| Non-U.S. Large Cap   | 23.2%                          |                      | 18.7% - 27.7%           |
| Non-U.S. Small Cap   | 2.9%                           |                      | 2.3% - 3.5%             |
| Emerging Markets   | <u>2.9%</u>                    |                      | 2.1% - 3.7%             |
| <b>Total Public Market Non-U.S. Equity Exposure<sup>2</sup></b>  |                                | <b>29.0%</b>         | <b>23.5% - 34.5%</b>    |
| <b>Total Public Market Equity Exposure<br/>(excluding PTRES)</b> |                                | <b>58.0%</b>         | <b>48.0% - 68.0%</b>    |
| <b>Private Markets</b>   |                                | <b>11.0%</b>         |                         |
| <b>Real Estate (including PTRES)</b>                             |                                |                      |                         |
| PTRES Portfolios   | 2.0%                           |                      | 1.7% - 2.3%             |
| Private Real Estate  | <u>6.0%</u>                    |                      |                         |
| <b>Real Estate (including PTRES)</b>                             |                                | <b>8.0%</b>          |                         |
| <b>Total Equity Exposure</b>                                     |                                | <b>77.0%</b>         | <b>71.0% - 83.0%</b>    |
| <b>Fixed Income Exposure</b>                                     |                                |                      |                         |
| TIPS   | 5.0%                           |                      | 4.4% - 5.6%             |
| U.S. Fixed Income  | 12.6%                          |                      | 11.3% - 13.9%           |
| Global Fixed Income  | 3.3%                           |                      | 2.6% - 4.0%             |
| High Yield   | 1.1%                           |                      | 0.9% - 1.3%             |
| Cash   | <u>0.0%</u>                    |                      |                         |
| <b>Total Fixed Income Exposure</b>                               | <b>22.0%</b>                   | <b>19.2% - 24.8%</b> |                         |
| <b>Commodity Exposure<sup>2</sup></b>                            |                                | <b>1.0%</b>          | <b>1.0% - 6.2%</b>      |
|  |                                | <b>100.0%</b>        |                         |

<sup>2</sup> The Board has approved an allocation of 5.0% to commodities to be funded equally from U.S. and non-U.S. equity exposure. This allocation is to be implemented over the next 12 to 18 months. Capital committed to commodities will be raised from U.S. and non-U.S. equities. For example, if 1.0% of the fund is allocated to commodities in a quarter, then 0.5% will be funded from the U.S. equity allocation and 0.5% will be funded from the non-U.S. equity allocation. This process will continue until 5.0% has been allocated to commodities and the allocation to U.S. equity drops to 27.0% and the allocation to non-U.S. equity drops to 27.0%.

The targets established above are long-term targets. Implementation of any private market strategies in real estate and private markets are, at a minimum, three to five year targets.

The policy ranges for the Asset Allocation represent rebalancing triggers. Since each asset class has different mean and standard deviation of returns, the rebalance triggers are set to be asset specific, based on the standard deviation of expected returns rather than using a fixed percentage band. The methodology used to set the rebalancing triggers is as follows:

- For Total Equity Exposure, the range is based on a 0.5 standard deviation move
  - For Total Public Market U.S. and Non-U.S. Equity Exposure, including the sub-components, the range is based on a 1.0 standard deviation move
- For Total Fixed Income Exposure and its sub-components, the range is based on a 2.0 standard deviation move
- For Commodity Exposure, the range is based initially no allocation on the lower band and a 2.0 standard deviation move above the 5.0% target for the upper band

For purposes of this analysis, cash and cash equivalents held in each Investment Manager's portfolio will be considered fully invested based on that advisor's objectives (i.e. cash in a U.S. equity Investment Manager's account will be considered as part of the U.S. equities in the table above). For classification purposes, cash equivalents include fixed income securities maturing in less than one year.

## Exhibit C

Based on the Asset Allocation in **Exhibit B**, the Board adopts the following weighted policy benchmarks to measure the performance of the System beginning April 1, 2007:

|   |                    |
|---|--------------------|
| <b>Public Market U.S. Equity Exposure</b>                 |                    |
| DJ Wilshire 5000 Index                                    | 29.0% <sup>3</sup> |
| <b>Public Market Non-U.S. Equity Exposure</b>             |                    |
| MSCI ACW Index ex. U.S. (gross dividends), 30% hedged     | 29.0% <sup>3</sup> |
| <b>U.S. Fixed Income and High Yield</b>                   |                    |
| Lehman Brothers U.S. Universal Index                      | 13.7%              |
| <b>TIPS</b>   |                    |
| Lehman Brothers U.S. TIPS Index                           | 5.0%               |
| <b>Global Fixed Income</b>                                |                    |
| Lehman Brothers Multiverse Index                          | 3.3%               |
| <b>PTRES Portfolios</b>                                   |                    |
| FTSE EPRA/NAREIT Global Real Estate Index                 | 2.0%               |
| <b>Private Real Estate</b>                                |                    |
| NCREIF Index, one-quarter lagged                          | 6.0%               |
| <b>Private Markets</b>                                    |                    |
| Venture Economics Median, one-quarter lagged <sup>4</sup> | 11.0%              |
| <b>Commodities</b>  |                    |
| DJ/AIG Commodity Index                                    | 1.0% <sup>3</sup>  |
| <hr/>   |                    |
| Total   | <u>100.0%</u>      |

<sup>3</sup> As the commodity allocation is funded, the equity benchmarks will be revised to reflect this funding. For example, if 1.0% of fund is allocated to commodities in the first quarter, then starting with the second quarter the Policy Index will include this 1.0% DJ/AIG Commodity Index and the DJ Wilshire 5000 Index will be reduced by 0.5% and the MSCI ACW Index ex. U.S. (gross dividends), 30% hedged benchmark will also be reduced by 0.5%. This process will continue until 5.0% has been benchmarked to commodities (DJ/AIG Commodity Index) and the benchmark to U.S. equity (DJ Wilshire 5000 Index) drops to 27.0% and the benchmark to non-U.S. equity (MSCI ACW Index ex. U.S. (gross dividends), 30% hedged) drops to 27.0%.

<sup>4</sup> The Venture Economics Median returns will be calculated on a weighted vintage year basis that will account for the timing of commitments made by the System.

## Exhibit D

All allocations to Investment Manager portfolios shall be subject to the limits established by the Board through the Asset Allocation in **Exhibit B**. IOS is permitted to manage the allocation of capital to each Investment Manager portfolio within the target ranges to public market Investment Manager portfolios to the total fund noted below. The CIO shall have discretion on the timing of reducing any Investment Manager portfolio exceeding the maximum ranges approved below. However, the CIO is not permitted to allocate additional capital to those portfolios currently outside the target ranges.

|  | <u>Target Ranges<br/>as a Percentage<br/>of the Total Fund</u> |
|--|--|
| <b>Public Market U.S. Equity Portfolios</b>        |  |
| Internally Managed S&P 500 Index                   | 0.0% - 20.0%   |
| Global Macro, including Overlay                    | 0.0% - 1.3%  |
| Internally Managed Enhanced S&P 500 Index          | 0.0% - 2.0%  |
| Enhanced S&P 500 Index                             | 0.0% - 2.0%  |
| Portable Alpha - Currency                          | 0.0% - 0.5% <sup>4</sup>                                       |
| Internally Managed S&P 400 Index                   | 0.0% - 2.5%  |
| Internally Managed S&P 600 Index                   | 0.0% - 2.5%  |
| Active Mid and Small Cap U.S. Equity               | 0.0% - 1.0%  |
| Active Micro Cap U.S. Equity                       | 0.0% - 0.5%  |
| <b>Public Market Non-U.S. Equity Portfolios</b>    |  |
| Internally Managed MSCI ACW Index ex. U.S.         | 0.0% - 15.0%   |
| Active Large Cap Non-U.S. Equity                   | 0.0% - 2.5%  |
| Active Small Cap Non-U.S. Equity                   | 0.0% - 1.0%  |
| Active Emerging Market Equity                      | 0.0% - 1.0%  |
| Currency Hedge                                     | See note below <sup>5</sup>                                    |
| <b>U.S. Fixed Income and High Yield Portfolios</b> |  |
| Internally Managed U.S. Core Fixed Income          | 0.0% - 5.0%  |
| Active Core Plus U.S. Fixed Income                 | 0.0% - 2.0%  |
| Active High Yield Fixed Income                     | 0.0% - 1.5%  |
| <b>TIPS Portfolios</b>                             |  |
| Internally Managed U.S. TIPS                       | 0.0% - 5.0%  |
| Active U.S. and Non-U.S. TIPS                      | 0.0% - 2.5%  |
| <b>Global Fixed Income Portfolios</b>              |  |
| Active Global Fixed Income                         | 0.0% - 2.0%  |

<sup>4</sup> Portable Alpha - Currency portfolios without capital requirements will be subject to a maximum of \$1.0 billion notional at 4.0% tracking error.

<sup>5</sup> The Currency Hedge will be for up to 30% of the Non-U.S. Equity Portfolio.

Target Ranges  
as a percentage  
of the Total Fund

**Cash Portfolios**

|  |             |
|--|-------------|
| Internally Managed LIBOR-Plus Short-Term Investment Pool | 0.0% - 5.0% |
| Short-Term Investment Pool managed by Treasury           | No limit    |

**PTRES Portfolios**

|              |             |
|--------------|-------------|
| Active PTRES | 0.0% - 1.0% |
|--------------|-------------|

**Commodities Portfolios**

|                                     |             |
|-------------------------------------|-------------|
| Active and Enhanced Index Commodity | 0.0% - 2.0% |
|-------------------------------------|-------------|

## Exhibit E

### Model Letter of Understanding

Thank you for your interest in the Pennsylvania Public School Employees' Retirement System's (PSERS) Private Equity Program. PSERS has adopted several requirements to which a prospective general partner must agree prior to our staff performing due diligence on a potential private equity partnership investment.

We are requesting the general partner's acknowledgement of and consent to the basic terms enumerated below. To promote an understanding of the applicable concepts, we have attached a form of indemnification provision and form of side letter agreement. Other terms should be self-explanatory. PSERS' terms may be incorporated into the main partnership agreement, a separate partnership agreement between the general partner and PSERS, or a letter agreement.

- The general partner must contribute 5 percent of the aggregate committed capital as a general partner and must subordinate 10 percent of PSERS' contribution in terms of the distribution schedule, which puts the general partner in a first loss position with respect to PSERS. The subordination can be accomplished through the distribution schedule, an escrow account or a parent company guarantee.
- The partnership must provide a preferred return to all limited partners of no less than 8 percent.
- The partnership must make available contractual co-investment rights to investors on a pro rata basis.
- Management fees and any other payment obligations undertaken by PSERS must be payable from (*not* in addition to) and reduce PSERS' capital commitment. PSERS' liability cannot exceed its capital commitment.
- Indemnifications by the partnership must be controlled by the standard and process set forth in the attached Model Provision.
- PSERS requires a "no fault divorce" provision that gives us the option to discontinue capital contributions if the Partnership has at least two instances of indemnification of \$500,000 or more.
- PSERS requires a seat on limited partner advisory and valuation committees, along with the right to appoint a successor to its member. The committees should possess rights to act on certain matters.

- The partnership must reimburse PSERS for the expenses incurred in attending advisory/valuation committee meetings and partnership annual meetings.
- PSERS may, in its discretion, require a key person provision in the event that one or more designated persons is no longer involved in the partnership at the prescribed levels.
- PSERS requires the partnership to issue financial statements on a Generally Accepted Accounting Principles (GAAP) basis.
- The general partner must execute the attached form of Model Side Letter Agreement or incorporate its terms and conditions into the partnership agreement.
- The Partnership shall not knowingly make investments in portfolio companies that outsource or privatize the jobs of active members of the Pennsylvania Public School Employees' Retirement System.

If these requirements are acceptable to your firm, please execute and return a copy of this letter to my office. This letter sets forth the understanding between PSERS and the undersigned general partner.

Sincerely,

Director of Private Markets & Real Estate

The undersigned General Partner hereby agrees to the above terms.

\_\_\_\_\_  
General Partner

By:

\_\_\_\_\_  
Name:

\_\_\_\_\_  
Title:

\_\_\_\_\_



## Model Provision

### Liability to Partners; Indemnification.

(a) Neither the General Partner or any partner of the General Partner (each a “Covered Party” and collectively the “Covered Parties”) shall be liable to any Partner for any action taken or omitted to be taken by such Covered Party or for any action taken or omitted to be taken by any other Partner or other person with respect to the Partnership, except in any of the following cases (and with respect to any member of the Advisory Committee, except only in the case of clause (iv) below):

(i) the case of such Covered Party’s own failure to exercise the care, skill, prudence and diligence under the circumstances then prevailing which persons of prudence, discretion, and intelligence who are experts in such matters exercise in the conduct of a venture capital enterprise with similar purposes;

(ii) the case of the Covered Party’s material violation of any law, including but not limited to, violation of any federal or state securities laws;

(iii) the case of such Covered Party’s material breach of this Agreement, the Investment Management Agreement, or any other agreement between the Partnership and the General Partner, the Investment Manager, or their Affiliates; or

(iv) the case of such Covered Party’s self dealing, bad faith or willful misconduct.

(b) The Partnership shall indemnify and hold harmless the Covered Parties, to the extent permitted by applicable law, from any and all reasonable costs and expenses and any and all damages and claims that may be incurred or asserted against such persons or entities by reason of any action taken or omitted to be taken on behalf of the Partnership unless such cost, expense, damage, or claim arises out of a case described in (a)(i) to (iv), above, or in the case of such Covered Party’s claim for indemnification arising out of any claim brought by an Affiliate of the General Partner (other than a Portfolio Company, prior Portfolio Company or Affiliate thereof).

(c) If any Covered Party seeks indemnification from the Partnership pursuant to this section, it shall so notify the Partnership and the Valuation Committee and shall present to the Valuation Committee any proposed settlement arrangement giving rise to the indemnification obligation under this section for the approval of the Valuation Committee, which approval shall not be unreasonably withheld. No Covered Party shall enter into any settlement agreement without the approval of the Valuation Committee. If the Valuation Committee shall determine that such Covered Party shall be entitled to

indemnification under this section, such determination shall be binding on the Partners and the Partnership.

(d) Subject to Subsection (e) below, expenses incurred by any person or entity entitled to indemnification in respect of any costs, expenses, damages and claims up to a maximum in the aggregate of \$\_\_\_\_\_ may be paid by the Partnership in advance of the final disposition of any such claim or action in the discretion of the General Partner upon the receipt of an undertaking by or on behalf of such person to repay the amount if it shall ultimately be determined that such person is not entitled to be indemnified by the Partnership as authorized by this section. Requests for advance payments in excess of \$\_\_\_\_\_ shall be submitted to and approved by the Valuation Committee in its discretion.

(e) Notwithstanding anything contained in this section to the contrary, no advance payment pursuant to Subsection (d) shall be made with respect to any action brought by a Limited Partner or any action brought by a Majority-in-Interest of the Limited Partners during the pendency of such a suit brought by such Limited Partner(s) and no payment shall be made if such Limited Partner(s) substantially prevails on the merits in such suit.

(f) The General Partner shall use commercially reasonable efforts to obtain the funds needed to satisfy the Partnership's indemnification obligations under this Section \_\_\_ from Persons other than the Partners or the Partnership (for example, pursuant to insurance policies that provide primary coverage or Portfolio Company indemnification arrangements) before causing the Partnership to make payments pursuant to this Section \_\_\_. The General Partner shall not be permitted to purchase insurance at the expense of the Partnership that would provide coverage for liabilities and expenses for which the General Partner or any other indemnified parties would not be entitled to indemnification under this Section \_\_\_ (for example, errors and omissions coverage for liabilities and expenses resulting from the negligence of the indemnified party).

(g) The Partnership shall not make any capital call for the purpose of making an investment in any Portfolio Company if the General Partner has actual knowledge or reason to believe that such Portfolio Company intends to use the proceeds from such investment to indemnify any Covered Party.

(h) If a Limited Partner shall default in respect of its obligation to contribute capital to the Partnership, the Partnership shall not make a call for capital to be contributed by the non-defaulting Limited Partners to satisfy a claim for indemnification under this section in excess of the amount that such non-defaulting Limited Partners would have contributed to the Partnership had the defaulting Limited Partners made its capital contribution.

\_\_\_\_\_, L.P.

\_\_\_\_\_, 200\_

Commonwealth of Pennsylvania  
Public School Employees' Retirement System  
Five North Fifth Street  
Harrisburg, Pennsylvania 17101

Attention:

Chief Investment Officer

Re: \_\_\_\_\_, L.P.

Dear Mr. Van Noord:

This letter is being written and delivered to confirm certain agreements with regard to the investment made by the Public School Employees' Retirement System ("PSERS") in \_\_\_\_\_, L.P., a [NAME OF STATE] limited partnership (the "Partnership"), pursuant to the Limited Partnership Agreement dated as of \_\_\_\_\_, 20\_\_ (the "Agreement") of the Partnership and the Subscription Agreement among the Partnership, the General Partner and PSERS dated as of \_\_\_\_\_, 20\_\_. Capitalized terms used herein and not otherwise defined shall have the meanings given to them in the Agreement.

The General Partner, on behalf of the Partnership, and PSERS agree that the terms of this letter agreement shall be applicable to the investment by PSERS in the Partnership, notwithstanding anything to the contrary contained in the Partnership Agreement or the Subscription Agreement. The terms of this letter agreement supersedes any conflicting term(s) in the Partnership Agreement or the Subscription Agreement.

1. The General Partner understands that PSERS reserves all immunities, defenses, rights or actions arising out of its status as a sovereign entity, including those under the Eleventh Amendment to the United States Constitution. No provision of the Agreement or the Subscription Agreement shall be construed as a waiver or limitation of such immunities, defenses, rights or actions.

2. The General Partner hereby agrees and acknowledges that any legal proceeding involving any contract claim asserted against PSERS arising out of the Agreement or the Subscription Agreement may only be brought before and

subject to the exclusive jurisdiction of the Board of Claims of the Commonwealth of Pennsylvania pursuant to 62 Pa. C.S. §§1721-1726, and that such proceeding shall be governed by the procedural rules and laws of the Commonwealth of Pennsylvania, without regard to the principles of conflicts of law.

3. The General Partner hereby confirms that the Agreement and the Subscription Agreement do not impose any personal indemnification obligations on PSERS and shall not be applied or construed to require PSERS to provide indemnification directly to any person or entity thereunder. PSERS, however, acknowledges that it is obligated as a Limited Partner to make capital contributions as called pursuant to the terms of the Agreement.

4. In compliance with PSERS' enabling legislation, 24 Pa. C.S. §8521(i), the liability of PSERS shall be limited to the amount of its capital commitment.

5. The General Partner agrees to appoint one representative designated by PSERS on the limited partner advisory/valuation committee and to accept a successor appointee designated by PSERS in the event such representative is removed or is no longer able to serve. The Partnership shall reimburse PSERS the travel and related expenses for attending advisory/valuation committee meetings and annual or special partnership meetings.

6. If upon the liquidation of the Partnership there shall be any Securities that are non-marketable, then in lieu of distributing to PSERS its share of such Securities, the General Partner shall use its reasonable best efforts to dispose of such Securities. In the event the General Partner is unable to dispose of such Securities within a reasonable period of time, the General Partner shall give PSERS at least ten business days prior written notice of its intention to make a distribution in kind of such Securities to PSERS. PSERS may within such notice period elect, by written notice to the General Partner or liquidating trustee, as applicable, to decline the receipt of such distribution in kind. In the event that PSERS elects to decline the receipt of the proposed in kind distribution, the General Partner or liquidating trustee, as the case may be, shall hold such Securities for the benefit of PSERS until such Securities are liquidated. The General Partner shall liquidate such Securities at the same time and on the same terms as the General Partner's liquidation of its own holdings of such Securities. PSERS shall bear only its pro rata share of the out of pocket expenses of such liquidating trust. The General Partner shall not allocate any non Publicly Traded Securities to PSERS relating to an investment from which PSERS was excused or excluded under the terms of the Agreement.

7. The General Partner hereby agrees to preserve all financial and accounting records pertaining to the Partnership Agreement during the term of the Agreement and for four years thereafter, and during such period, PSERS or

any other department or representatives of the Commonwealth of Pennsylvania, upon reasonable notice, shall have the right to audit such records in regard thereto to the fullest extent permitted by law. The General Partner shall have the right to preserve all records and accounts in original form or on microfilm, magnetic tape, or any similar process.

8. The General Partner agrees that it shall not knowingly and willfully take or fail to take any action that would cause the auditor's report on the annual financial statements provided by the General Partner pursuant to Section \_\_\_\_\_ of the Agreement to include any qualification due to scope limitation, lack of sufficient competent evidential matter, or a departure from Generally Accepted Accounting Principles.

9. The Partnership and General Partner represent and warrant that none of the Partnership, the General Partner or the individual partners of the General Partner has entered or will enter into any side letter or similar agreement on or prior to the date hereof with any investor or Partner in the Partnership or with any investor in the Parallel Funds or side by side funds in connection with the admission of such investor or Partner to the Partnership, Parallel Funds or side by side funds except as disclosed to PSERS in writing on or prior to the date hereof. If the Partnership, the General Partner or the individual partners of the General Partner shall enter into a side letter or similar agreement with an existing or future investor, PSERS shall promptly be given a copy of such agreement and the opportunity to obtain the same rights and benefits of such side letter or similar agreement by written notice thereof to the General Partner delivered within 30 days of receipt by PSERS of copies of such side letters or similar agreements.

10. The General Partner (i) understands and acknowledges that it is subject to the reporting requirements set forth in 25 P.S. § 3260a., (ii) if required to file a report, confirms that it has submitted to PSERS' Executive Director a copy of its current report to the Secretary of the Commonwealth of Pennsylvania, and (iii) if required to file successive reports, hereby agrees to submit a copy of each successive report to PSERS' Executive Director by February 15 of each year during the term of this Agreement.

11. For as long as PSERS is a Limited Partner, the General Partner agrees that it will not obtain, at the expense of the Partnership or any Limited Partner, any insurance that would provide for indemnification of any Covered Person for any liability with respect to which a Covered Person would not be entitled to indemnification pursuant to the Partnership Agreement.

12. The General Partner acknowledges that PSERS is an administrative agency of the Commonwealth of Pennsylvania and may be required by law to disclose to the public certain information that may be considered confidential under this Agreement ("Disclosure Obligations").

Therefore, notwithstanding anything to the contrary in the Agreement, the General Partner hereby agrees that PSERS, without prior notice to or approval of the General Partner, may disclose to the public the following information regarding the Partnership to satisfy such Disclosure Obligations:

- i. The name, address, and vintage year of each alternative investment vehicle;
- ii. The identity of the manager of each alternative investment vehicle;
- iii. The dollar amount of the commitment made by the System to each alternative investment vehicle;
- iv. The dollar amount of cash contributions made by the System to each alternative investment vehicle since inception;
- v. The dollar amount of cash distributions received by the System from each alternative investment vehicle since inception;
- vi. The net internal rate of return of each alternative investment vehicle since inception, provided that the System shall not be required to disclose the net internal rate of return under circumstances which, because of the limited number of portfolio assets remaining in an alternative investment vehicle, such disclosure could reveal the values of specifically identifiable remaining portfolio assets to the detriment of the alternative investment;
- vii. The aggregate value of the remaining portfolio assets attributable to the System's investment in each alternative investment vehicle, provided that the System shall not be required to disclose said value under circumstances in which, because of the limited number of portfolio assets remaining in an alternative investment vehicle, such disclosure could reveal the values of specifically identifiable remaining portfolio assets to the detriment of the alternative investment; and,
- viii. The dollar amount of total management fees and costs paid to each alternative investment vehicle by the System on an annual fiscal year-end basis.

The General Partner further acknowledges that the types of information identified in (i) through (vi) above are not inclusive of all the information that PSERS may be required to disclose.

PSERS will not, however, without the prior written consent of the General Partner, disclose any information regarding the identity, performance, or value of

any portfolio company, proprietary business information relating to the services or products of any portfolio company, or the Partnership's pending acquisition or pending disposition of a portfolio company or proposed investment in a portfolio company ("Trade Secrets"). In the event that PSERS is required by law (any statute, governmental rule or regulation, or judicial or governmental order, judgment or decree) to disclose Trade Secrets, the General Partner has the right not to disclose further to PSERS the types of Trade Secrets that PSERS is required by law to disclose, provided, that the General Partner agrees not to withhold from PSERS (w) such information as is reasonably necessary for PSERS to determine the items set forth in (i) through (vi) above, (x) balance sheets, statements of portfolio investments (including cost and value), income statements and statements of cash flow of the Partnership, (y) the capital account balance of PSERS (prepared in the Partnership's quarterly and annual financial statements and in PSERS' Capital Account Summary delivered to PSERS pursuant to this Agreement), and (z) federal and state tax information statements (including Federal Form K-1).

Sincerely yours,

\_\_\_\_\_, L.P.

By: \_\_\_\_\_

By: \_\_\_\_\_

Agreed to and Acknowledged:

COMMONWEALTH OF PENNSYLVANIA  
PUBLIC SCHOOL EMPLOYEES' RETIREMENT  
SYSTEM

By: \_\_\_\_\_

Name:

Title:

By: \_\_\_\_\_

Name:

Title:

Approved for form and legality:

\_\_\_\_\_  
Chief Counsel

Public School Employees'  
Retirement System

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Chief Deputy Attorney General  
Office of Attorney General

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Deputy General Counsel  
Office of General Counsel



Exhibit F

***Developmental Fund Policy  
Of  
The Commonwealth of Pennsylvania  
Public School Employees' Retirement System***

As adopted by  
the Board of Trustees  
on April 29, 2004

Effective  
April 29, 2004

Adopted: April 29, 2004  
Revised: April 28, 2006  
Date Last Reviewed by Chief Investment Officer: April 28, 2006

**PUBLIC SCHOOL EMPLOYEES' RETIREMENT BOARD**  
**DEVELOPMENTAL FUND POLICY**

**I. OBJECTIVES AND GOALS**

The Pennsylvania Public School Employees' Retirement System (PSERS) has established the Developmental Fund, consistent with Commonwealth of Pennsylvania policies and procedures; to assist emerging minority, women, and Pennsylvania-based investment management firms.

The Developmental Fund is an internally managed program that is administered by PSERS' Developmental Fund Manager (DFM) and has been operating since April 1, 1995. Each manager selected for the Developmental Fund receives an initial allocation of \$15 million with the opportunity to receive up to \$35 million.

**II. DEVELOPMENTAL FUND CRITERIA**

Managers electing to participate in the program must meet the following criteria:

- ◆ Pennsylvania investment management firms must be headquartered or incorporated within the Commonwealth;
- ◆ Minority-or women-owned investment management firms must be approved by the Office of Minority and Women Business Enterprise in accordance with the criteria established by Executive Order No. 1987-18 and 4 Pennsylvania Code, Section 68.204;
- ◆ Firms must have an historical, three year performance record verified by at least one consultant or accounting firm in accordance with AIMR standards;
- ◆ Firms must have at least three distinctly different clients;
- ◆ Firms must have a minimum of \$45 million and no more than \$1.50 billion of total capital under management when hired (existing managers will be terminated at \$3.0 billion);
- ◆ At the time of hiring and with each additional funding, PSERS' allocation can comprise no more than 25% of the capital under management; and,
- ◆ At the time of hiring and with each additional funding, PSERS' allocation can comprise no more than 25% of the capital of any one portfolio.

***Please note:*** Firms applying for participation under the status of a Women and/or Minority Owned Business must contact the Office of Minority & Women Business Enterprise at (717) 787-7380 to obtain the proper certification material.

**III. STAFF AUTHORITY TO HIRE/RETAIN MANAGERS**

Staff has the authority to hire and fund any manager meeting the criteria set forth above as long as capacity exists under the Board-approved asset allocation plan. Staff approval required to hire any manager include the Chief Investment Officer (CIO), the Director of Private Markets & Real Estate (DPMRE), and the DFM.

Staff is required to obtain Board approval in instances when the CIO, DPMRE, and DFM locate (or have retained) an exceptional manager that does not meet one or more of the above criteria. In these cases, staff shall prepare a presentation documenting the specific reasons for

recommending the manager. Upon approval of the Board, staff shall have the authority to fund the managers according to VI. Fundings, below.

#### **IV. INVESTMENT GUIDELINES**

Each manager shall manage its portfolio within the constraints of the applicable Board-approved Investment Objectives and Guidelines.

#### **V. INSURANCE**

All of the standard insurance provisions set forth in the Investment Objectives and Guidelines except for the minimum amounts and maximum deductibles will apply to the managers until they are either managing over \$100 million for the Developmental Fund or are moved out of the Developmental Fund into the main Fund. The minimum amounts and maximum deductibles for the managers are as follows:

##### **Professional Liability Insurance (E&O Insurance)**

Each manager will be required to have professional liability insurance with the following minimum amounts of coverage and maximum deductibles:

| <u>Asset Size (in millions)</u> | <u>Minimum Amount of E&amp;O Insurance</u> | <u>Maximum Deductible</u> |
|---------------------------------|--|---------------------------|
| \$0 - \$50                      | \$ 500,000                                 | \$ 50,000                 |
| \$50 - \$75                     | \$1,000,000                                | \$100,000                 |
| \$75 - \$100                    | \$2,000,000                                | \$200,000                 |

##### **Fidelity Bond**

Each manager will be required to have a fidelity bond with the following minimum amounts of coverage and maximum deductibles:

| <u>Asset Size (in millions)</u> | <u>Minimum Amount of Fidelity Bond</u> | <u>Maximum Deductible</u> |
|---------------------------------|--|---------------------------|
| \$0 - \$50                      | \$1,000,000                            | \$ 50,000                 |
| \$50 - \$75                     | \$1,500,000                            | \$100,000                 |
| \$75 - \$100                    | \$2,000,000                            | \$200,000                 |

#### **VI. FUNDINGS**

Each manager hired will be funded with an initial allocation of \$15 million. Each manager is then eligible for up to two additional allocations of \$10 million subject to satisfactory performance, approval of the CIO, DPMRE, and DFM, and sufficient capacity within the Board-approved asset allocation plan.