



DATE: July 22, 2019
SUBJECT: Proposed Revisions to Investment Policy Statement, Objectives, and
Guidelines – Non-Traditional Investments Policy
TO: Members of the Board
FROM: Joseph W. Sheva, CPA, FRM
Senior Risk Manager

At the August Investment Committee meeting, the Investment Office will recommend that the Board adopt the Investment Policy Statement, Objectives and Guidelines (IPS) revisions to sections VI. Risk Management and Controls and VII. Monitoring and Reporting with an effective date of October 1, 2019, as noted below.

VI. Risk Management and Controls: Investment Manager Objectives and Guidelines – C. Private Market Policies and Guidelines

The Investment Office recommends changing the name of this section to Non-Traditional Investments Policies and Guidelines and removing the following Addenda (U, V, X and X1) referenced within this section and replacing them with the Non-Traditional Investments Policy. Attached are a memo from Hamilton Lane, the Board's Non-traditional investment consultant, regarding the policy's consistency with industry best practices and a memo from Cohen Milstein Sellers & Toll PLLC, the Board's Fiduciary Counsel, regarding the policy development process.

Real Estate Guidelines – Private

U CLOSED-END OPPORTUNISTIC AND VALUE-ADDED REAL ESTATE INVESTMENTS

V REAL ESTATE PROGRAM

Private Market Guidelines

X PRIVATE INVESTMENT AND VENTURE CAPITAL POLICY

X1 PRIVATE DEBT POLICY

VII. Monitoring and Reporting – Selection of Managers

Upon the adoption of the Non-Traditional Investments Policy, as recommended above, the Investment Office recommends removing the references to Private Markets, including Private Debt, Private Equity, Venture Capital and Real Estate from this section of the IPS. The Non-Traditional Investments Policy contains the process related to manager selection.

Specific attachments referenced in the above sections, along with a blacklined excerpt and clean copy of the applicable sections within the IPS, have been included in the package for your review.

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



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Suzanne M. Dugan
(202) 408-4600
sdugan@cohenmilstein.com

July 3, 2019

Board of Trustees
Commonwealth of Pennsylvania
Public School Employees' Retirement System
5 North 5th Street
Harrisburg, PA 17101

Re: *Proposed Draft Non-Traditional Investment Policy Statement*

Dear Trustees:

In my capacity as Fiduciary Counsel to the Board of Trustees of the Public School Employees' Retirement System, I have reviewed and provided input on the proposed Non-Traditional Investment Policy ("Policy"). More importantly from my perspective, I have reviewed the process that was undertaken in order to draft the Policy. As you know, fiduciaries are judged by the process undertaken to reach decisions, and establishment of a reasonable decision-making process and adherence to that process helps to demonstrate prudence. Moreover, documentation of process is an important part of demonstrating prudence. In this case, it appears to me that the process undertaken is procedurally prudent, and that the review process has been sufficiently memorialized in order to demonstrate such prudence.

Sincerely,



Suzanne M. Dugan



Hamilton Lane

June 26, 2019

Board of Trustees
Commonwealth of Pennsylvania
Public School Employees' Retirement System
5 North 5th Street
Harrisburg, PA 17101

Re: Non-Traditional Investment Policy Statement

Dear Trustees:

In its role as Consultant for the Commonwealth of Pennsylvania, Public School Employees' Retirement System's Private Markets, High Yield & Private Credit, and Private Real Assets Portfolios, Hamilton Lane has reviewed and assisted in the drafting of the proposed Non-Traditional Investment Policy Statement ("the Non-Traditional IPS") and believes that the Non-Traditional IPS is consistent with industry best practices. The Non-Traditional IPS, as drafted, provides a framework for the Portfolios, as well as guidance to ensure prudence and care in the execution of the respective Non-Traditional Investment Portfolios.

Sincerely,

Michael Koenig,
Chief Client Officer

Corina English,
Principal

C. Private Market Policies and Guidelines

The following represent Private Market program policies and guidelines.

Pennsylvania Mortgage Program Guidelines

R PENNSYLVANIA MORTGAGE PROGRAM GUIDELINES & PROCEDURES

Real Estate Guidelines – Private

S OPEN-END REAL ESTATE FUND INVESTMENTS

~~U CLOSED-END OPPORTUNISTIC AND VALUE-ADDED REAL ESTATE INVESTMENTS~~

~~V REAL ESTATE PROGRAM~~

W FARMLAND INVESTMENT PROGRAM

X3-RE REAL ESTATE IN-HOUSE CO-INVESTMENT AND SECONDARY INVESTMENT POLICY

X-5 PRIVATE MARKETS AND REAL ESTATE PENNSYLVANIA IN-HOUSE CO-INVESTMENT INVESTMENT POLICY

Private Market Guidelines

~~X PRIVATE INVESTMENT AND VENTURE CAPITAL POLICY~~

~~X1 PRIVATE DEBT POLICY~~

X3-PD PRIVATE DEBT IN-HOUSE CO-INVESTMENT AND SECONDARY INVESTMENT POLICY

X3-PM PRIVATE MARKETS IN-HOUSE CO-INVESTMENT AND SECONDARY INVESTMENT POLICY

X-5 PRIVATE MARKETS AND REAL ESTATE PENNSYLVANIA IN-HOUSE CO-INVESTMENT INVESTMENT POLICY

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VII. Monitoring and Reporting

Selection of Investment Managers

The Board delegates to IOS the authority to conduct Investment Manager searches with the assistance of the appropriate Investment Consultant. No Investment Manager shall be presented to the Board for approval without a recommendation from both IOS and the appropriate Investment Consultant to allocate or commit capital to the Investment Manager. All Investment Managers, excluding PMEIM Program Investment Managers, shall be approved by the Board prior to full execution of a contract. The following are the selection procedures for Public Markets Investment Managers, ~~Private Markets Investment Managers (partnerships)~~, and PMEIM Program Investment Managers.

Public Markets excluding the PMEIM Program

A search for a public market equity, fixed income, commodity, real estate, or other 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, and/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 DCIO-Traditional Investments 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, DCIO-Traditional Investments, Internal Portfolio Manager and/or Senior Investment Analyst, and normally at least one of the other Investment Office Managing 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 DCIO-Traditional Investments, or other IOS designated by the DCIO-Traditional Investments, shall enter into fee and contract negotiations with each selected Investment Manager. If the DCIO-Traditional Investments is unable to negotiate an acceptable contract, which shall include the System's required contract provisions, the next best choice is selected, and this process continues until the Investment Manager and the System negotiate mutually acceptable contract terms. Once an agreement is reached, the selected Investment Manager(s) is recommended to the Investment 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 Markets 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 that outlines the following:

 - ~~• Specific deal terms required by the Investment Committee;~~
 - ~~• Indemnification contract language; and,~~
 - ~~• Sample side letter language.~~~~
- ~~• The prospective general partner shall also provide detailed information to 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 IOS and the specialty Investment Consultant agree 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 DCIO-Non-Traditional Investments, or other IOS designated by the DCIO-Non-Traditional Investments enters contract negotiations with the general partner.
- Assuming acceptable terms are agreed upon, the DCIO-Non-Traditional Investments or Internal Portfolio Manager will make a presentation to the Investment Committee. The Investment Committee and the Board are required to approve the investment prior executing a contract with the prospective fund.

PMEIM Program

The PMEIM Program is administered internally by the EMPM. The Public Markets Emerging Investment Manager Program Policy is approved by the Board by inclusion within the Investment Policy, Objectives and Guidelines, above in the Risk Management and Controls section.

Prospective firms are brought to the attention of the EMPM through other institutional investors, financial publications, word-of-mouth, contact directly by the Investment Manager, or the results of screening a database. The EMPM 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, among other considerations, philosophy, methodology, past performance, ethical standards; and,
- Perform an on-site visit at the Investment Manager's place of business.

The administration of this Program is more fully documented in the Risk Management and Controls section.