

Memo

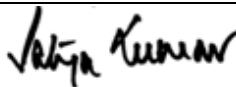
To: **Board of Trustees**

PSERS

CC: **James H. Grossman, Jr., CPA, CFA, Chief Investment Officer**

PSERS

From: Satya Kumar, CFA
Partner, Hewitt EnnisKnupp



Claire Shaughnessy, CFA
Partner, Hewitt EnnisKnupp



Date: September 12, 2014

Re: Deutsche Bank – Agency Securities Lending

Executive Summary

Hewitt EnnisKnupp (HEK), having been duly authorized by the Board of PSERS, has evaluated and recommends the retention of Deutsche Bank as PSERS' sole third-party securities lending agent, lending securities on PSERS' behalf on an indemnified repo basis, and reinvesting cash in line with conservative guidelines.

HEK maintains and monitors a roster of agency securities lending agents for our clients. Deutsche Bank is an approved third-party securities lending agent and is a rated a "buy", implying it is a strategy that we would recommend to clients considering the use of a third-party securities lending agent.

Deutsche Bank – Agency Securities Lending: Overview

The Deutsche Bank Securities Lending team was originally formed in 1997 by Deutsche Bank. The team underwent several ownership changes since 2002 as large global banks undertook strategic realignment of their product portfolios, but has now been back under the Deutsche Bank umbrella over the past five years. At this point, we do not believe that there is any cause for concern around the organization's commitment to the business.

The key individuals responsible for the securities lending business have worked together since the mid-1990s and the team is one of the longest-tenured teams in the industry. Within the U.S., the business is headed by Tim Smollen who has 22 years of experience in the securities lending business. Anthony Toscano, who heads lending trading, also has 22 years of experience.

Philosophy & Process

Deutsche Bank aims to maximize intrinsic income while employing very strict risk management. This is done in a highly customized manner for each client. A compelling aspect of Deutsche's lending program is their relatively small number of clients. Deutsche's tight client-to-employee ratio enables them to develop highly customized lending solutions to fit the needs and risk tolerances of each client. Deutsche focuses on maximizing intrinsic value by lending special, in-demand securities at the most competitive rates. Deutsche has adopted a high-touch client service approach to its securities lending program and seeks to add clients on a selective and strategic basis so as to ensure that additional assets are not dilutive to their existing program and clients.

Deutsche Bank supports both cash collateral and non-cash collateral. Deutsche is also a large proponent of repurchase agreements ("repos") as a form of collateral. Going into the 2008 financial crisis, many of Deutsche's client collateral portfolios consisted only of repos, which fared better than short-term bonds. Deutsche offers indemnified repo, and coverage includes not only overnight repos, but also term repos. Clients can elect to limit collateral to only indemnified repo, and coupled with the borrower default indemnification offering, create a fully indemnified securities lending program. In the event of insolvency or default by a repo counterparty, Deutsche Bank's indemnified repo program protects the client with respect to any shortfall between the liquidation proceeds of securities collateral received from the counterparty and the amount of cash deposited (invested) with counterparty. In the event of such shortfall, the bank is obligated to restore the full amount of cash collateral that was invested. Deutsche looks to diversify repo exposure across counterparties, collateral, and tenor. The bank's enterprise risk management group and asset management group oversee repo transactions.

Deutsche adopts a pragmatic approach to cash collateral reinvestment. They recognize that cash tied to securities lending is one of the largest single mandates within client portfolios and offer clients the flexibility to separate or diversify the reinvestment of cash collateral.

Conclusion

Deutsche Bank's securities lending program is one of the most mature third party lending programs in the industry. The team is among the longest tenured teams in the industry. The program is managed with an intense focus on risk management, which is one of the functions it leverages from the broader organization. Their selective addition of clients and their lending philosophy that is geared towards maximizing intrinsic revenue is attractive and beneficial for clients that have a significant allocation of specials within their portfolios. Deutsche looks to create custom programs with each client, including the manner in which collateral is managed.

The terms of the fee split that Deutsche has offered PSERS are consistent with what we have seen them offer other large clients with similar portfolio attributes. Additionally, the lending on an indemnified repo basis is a meaningful improvement as compared to the program that is in place today. HEK recommends that the Board retain Deutsche Bank as PSERS' sole third-party securities lending agent.

This recommendation is given solely for the benefit of PSERS and cannot be relied upon by other investors considering an investment in Deutsche Bank, since their needs, objectives and circumstances may not be identical to those of PSERS. The scope of this recommendation is limited to the investment merits of the Fund. HEK does not provide legal or other non-investment related advice.