



TREASURY DEPARTMENT  
COMMONWEALTH OF PENNSYLVANIA  
HARRISBURG, PA 17120

THE STATE TREASURER

May 20, 2008

The Honorable Steven R. Nickol  
Republican Chair  
House Finance Committee  
18 East Wing, Capitol Building  
Harrisburg, Pennsylvania 17120

Dear Representative Nickol:

Thank you for your interest in the various programs and investment funds that the Pennsylvania Treasury Department oversees on behalf of the residents of the Commonwealth. I appreciate the opportunity to explain these activities in greater detail.

In your letter, you requested information on five specific topics. Below, you will find my responses to each of your questions. In addition, several charts and a glossary of terms have been attached to this letter to supplement the answers provided below.

**1) The asset allocation policy for each pool and/or category, including ranges, as well as any risk tolerance and liquidity-need analysis performed for each pool and/or category of investments:**

The Pennsylvania Treasury Department is the third largest investor of Commonwealth funds after PSERS and SERS (Table 1). There are ten major pools (Table 2), broken down into the three categories that make up the total amount of active investments by the Treasury Department.

**Pool 98** - Pool 98, referred to as the Common Investment Pool, is driven by the liquidity needs of the Commonwealth, and sets a variable Net Asset Value Per Share. It is a mixed strategy that combines investing for liquid assets to meet current expenses, while at the same time investing the assets in excess of liquidity in long-term fixed income and equity securities. This strategy is designed to generate both income and capital appreciation.

This fund is the "Commonwealth's Checkbook," and as such is driven more by the timing of revenues and expenditures, rather than at the discretion of the Treasury Department. Due to the rapid frequency at which this fund fluctuates over a short period of time, strategies based on percentages or ranges become outdated.

**Tuition Account Program (TAP)** – The TAP Guaranteed Savings Plan (GSP) uses an actuarial analysis to determine current funding status and the return required to meet those needs. The TAP strategy is designed to meet the return with the lowest risk possible. This strategy does change over time, though, due to the ever-changing tuition inflation rates and volatile market.

**Other Pools/Programs** - All other Treasury managed assets follow the Cash and Cash Equivalent Strategy (Cash & CE), which seeks to maintain a stable Net Asset Value Per Share. This strategy is best characterized by investments in very short-term securities, including Treasury bills, agency discount notes, overnight repurchase agreements, and other very short-term fixed-income instruments. These investments have a final maturity time that does not exceed 13 months.

**2) A breakdown of all investments by pool and category, including funds internally and externally managed, indicating specific dollar amount allocations, strategies employed by each manager and appropriate benchmarking data:**

The Pennsylvania Treasury Department is the custodian of nearly \$122 billion in assets, and actively manages, either directly or indirectly, approximately \$19.1 billion. As mentioned above, the two major categories that are utilized by Treasury to invest Commonwealth funds are the Cash & CE and the Common Investment Pool.

The Common Investment Pool (Pool 98) can be broken down into Cash & CE, Domestic Fixed Income, Domestic Equity, Strategic Investment Opportunities, and Private Equity (Table 4). These investments are valued at just over \$9.1 billion. This investment pool is made up of three categories:

- **Short-Term Diversified Category** - may consist of short-term fixed income securities. The portfolios of this category are considered part of a Short-Term Component or a Two-Year Duration Target Component. (\$3,688 million, 40.5% of Pool)
- **Mixed-Term Diversified Category** - may consist of fixed income (including high yield) and equity securities, as well as alternative investments. The fixed income securities include short, intermediate, and long-term securities. The equity securities may range from small cap securities to large cap securities. (\$4,770 million, 52.4% of Pool)

- Strategic Investment Opportunities - may consist of certain multiple purpose investments such as the Homebuyer Program, the Agri-Link Program, the Commonwealth Time Deposit Program, the PHEEA HelpStart Program, Hospital Enhancement Loan Program, KeystoneHELP Program, and State of Israel Bonds. (\$648 million, 7.12% of Pool)

The TAP GSP follows the Mixed-Term Diversified Category described above.

The Cash & CE (Table 3) is a combination of certificates of deposits, commercial paper, federal agency investments, money market funds, and repurchase agreements. These investments may include:

- Securities issued by the United States Government and its agencies
- Corporate bonds rated Aa3/AA- or better at trade date
- Aaa/AAA rated non-agency-backed Asset Backed Securities (ABS), Commercial Mortgage Backed Securities (CMBS) and Collateralized Mortgage Obligations (CMO), up to a maximum of 10% each, with a combined maximum of 20%, of the market value of any portfolio at trade date
- Taxable municipal securities rated Aaa/AAA or better up to a maximum of 10% of the market value of any portfolio at trade date
- Adjustable rate securities up to 15% of the market value of any portfolio at trade date
- Mortgage-backed securities shall have final maturity that does not exceed 5 years from trade date
- Domestic negotiable certificates of deposit rated A-1 or better and P-1 or better
- Repurchase agreements collateralized at 102% of the market value plus accrued interest
- Commercial paper rated A-1 or better and P-1 or better
- Money market funds rated AAA or its equivalent
- Sweep vehicles approved by Treasury

**3) Fees paid to each external manager in the last fiscal or calendar year:**

External managers oversaw \$4.6 billion in investments for Pool 98 in 2007, and were paid a total of \$15.5 million in fees for their management, which is an average fee of 33 basis points. TAP GSP external managers oversaw \$1 billion in investments and were paid \$5.2 million in fees for an average fee of 49 basis points. The manager fees paid by Treasury tend to the lower end of the spectrum of equal size accounts in the private market.

The Honorable Steven R. Nickol

May 20, 2008

Page Four

The Treasury Department staff manages Cash & CE and Strategic Investment Opportunities internally; therefore, no management fees are incurred for these investments. A full list breakdown of the Pool 98 Investment Fund Manager Fees for calendar year 2007 can be found in Table 5.

A Cambridge Associates, LLC study of manager fees in 2006 showed that fees range by category and account size. For accounts of \$100 million or larger, manager fees ranged from 26.1 basis points to 92.1 basis points for U.S. Bonds (on the low end) and emerging market equity funds (higher end). Similarly for \$50 million to \$100 million accounts, the range for basis points charges were from 30 basis points (bond accounts) up to 61 basis points (mid and large cap equity) for active managerial account fees.

**4) An explanation of the benchmark criteria that Treasury plans to utilize for the investments in which “strategic factors” were applied and what these benchmarks are:**

Generally, benchmarks are not applied to an individual stock but instead are utilized for a whole portfolio. Therefore, instead of benchmarking individual investments, benchmarks are created for the entire portfolio based on the underlying investments and evaluation of the expected risk and return profile. Because the market is volatile and not static, these benchmarks are variable and can be subject to change.

**5) A further explanation of the discretionary asset category:**

The Treasury Department does not use the term discretionary, but rather Strategic Investment Opportunities (SIO). SIOs are investments that can do well for our funds and at the same time do good for Pennsylvania stakeholders.

A large share of the Strategic Investment Opportunities total investment is in municipal notes from PHEAA. This makes up over 77% of the entire portfolio, and is valued at over \$500 million. Other investments include the Board of Finance and Revenue Time Deposits, State of Israel Bonds, KeystoneHELP, Better Choice, Agri-Link, and Hospital Enhancement Loan Program (HELP). These investments vary in security type from certificate of deposits to whole loans. For a complete breakdown, see Table 6.

I hope I have adequately answered your request for additional information and strengthened your understanding of the Treasury Department’s investment activities. For your reference, Treasury’s investment policy can be found on our Department web site by visiting <http://www.patreasury.org/InvestmentCenter.htm#investpolicy>.

The Honorable Steven R. Nickol  
May 20, 2008  
Page Five

Again, I thank you for your interest, and I look forward to speaking with you further at the House Finance Committee hearing on May 20 concerning House Bill 2259.

Sincerely,

A handwritten signature in black ink that reads "Robin L. Wiessmann". The signature is written in a cursive style with a large, sweeping initial "R".

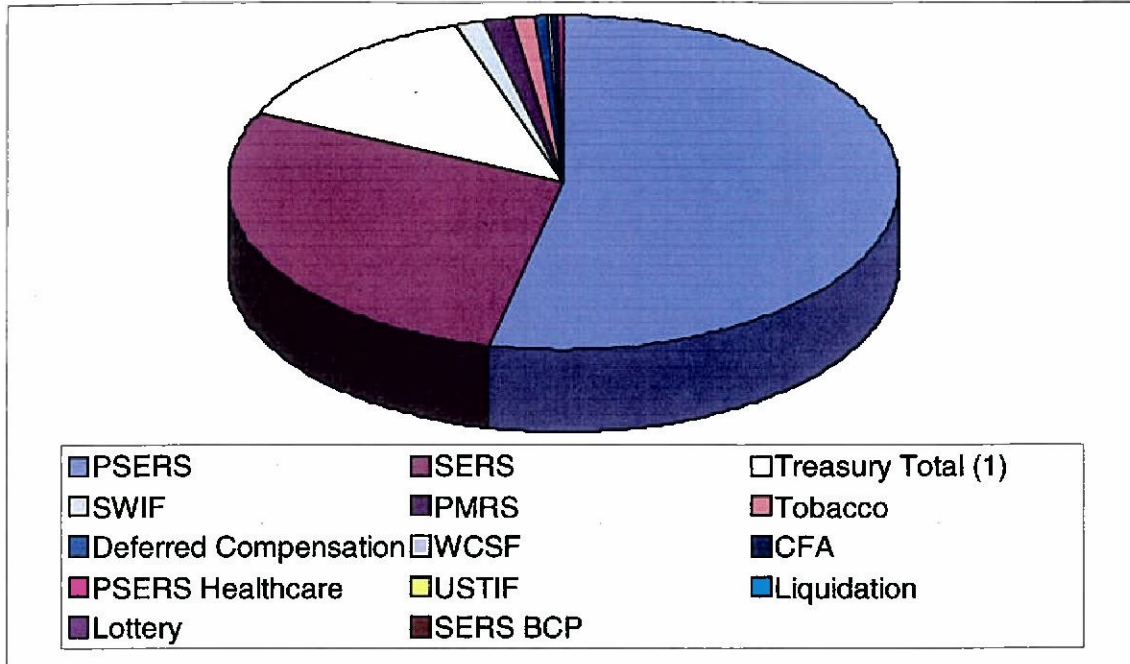
Robin L. Wiessmann  
State Treasurer

cc: The Honorable David Levdansky  
The Honorable Patrick Browne

Addendum Included

**Treasury Custodial Assets (Table 1)**

**NET ASSET VALUE UNDER  
AS OF APRIL 30, 2008**



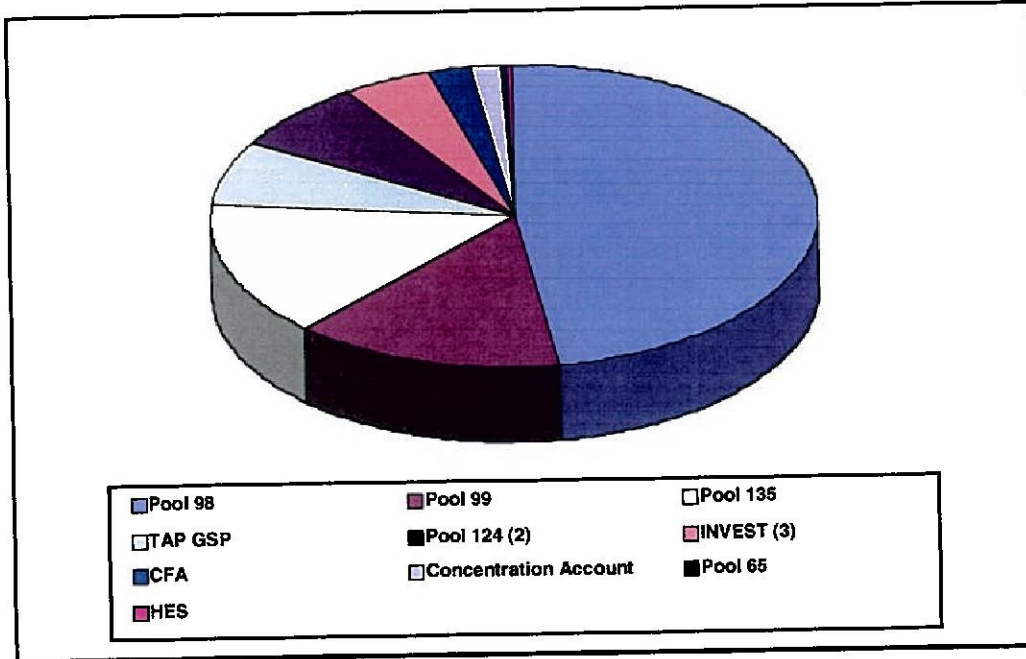
<b>PROGRAMS</b>		<b>NAV</b>	<b>% under Custody</b>
PSERS	\$	65,348,202,020	53.62%
SERS	\$	34,629,511,356	28.42%
Treasury Total <sup>(1)</sup>	\$	15,481,406,272	12.70%
SWIF	\$	1,786,564,360	1.47%
PMRS	\$	1,518,327,494	1.25%
Tobacco	\$	1,348,395,539	1.11%
Deferred Compensation	\$	576,493,985	0.47%
WCSF	\$	504,352,354	0.41%
CFA	\$	443,227,562	0.36%
PSERS Healthcare	\$	122,764,278	0.10%
USTIF	\$	91,237,072	0.07%
Liquidation	\$	5,702,070	0.00%
Lottery	\$	6,643,616	0.01%
SERS BCP	\$	4,841,167	0.00%
<b>Total under Custody</b>	<b>\$</b>	<b>121,867,669,144</b>	<b>100.00%</b>

\* Percentages may not sum to 100% due to rounding.

<sup>(1)</sup> Treasury includes Pool 98, Pool 99, Fund 65, HES, INVEST, Float, TAP, Securities Lending and Safekeeping

Treasury Managed Assets (Table 2)

**TREASURY INVESTMENT POOLS/PROGRAMS  
APRIL 30, 2008**



POOL / PROGRAM	NAV	% OF TOTAL <sup>(1)</sup>	STRATEGY
Pool 98 - Common Investment Pool	\$ 9,105,643,720	47.89%	Mixed
Pool 99 - Liquid Asset Pool	2,727,549,425	14.35%	Cash & CE
Pool 135 - Treasury PSERS / Separate Account	2,766,244,716	14.55%	Cash & CE
TAP GSP - Tuition Account Program Guaranteed Savings Plan	1,275,955,837	6.71%	Mixed
Pool 124 <sup>(2)</sup> - Treasury Global Investment Fund	1,375,317,702	7.23%	Cash & CE
INVEST <sup>(3)</sup>	891,258,168	4.69%	Cash & CE
CFA - Commonwealth Financing Authority	443,168,646	2.33%	Cash & CE
Concentration Account (Float)	301,016,624	1.58%	Cash & CE
Pool 65 - Worker's Compensation Administration Fund	97,242,747	0.51%	Cash & CE
HES - Higher Education System	29,218,897	0.15%	Cash & CE
<b>TOTALS</b>	<b>\$ 19,012,616,482</b>	<b>100.00%</b>	

<sup>(1)</sup> Percentages may not sum to 100% due to rounding

<sup>(2)</sup> Pool 124 net asset value excludes 138,802,282 TAP GSP units

<sup>(3)</sup> INVEST net asset value includes balances for INVEST Daily, 3, 10 and INVEST Custom Pools

**Treasury Investment Pools/Programs by Strategy**

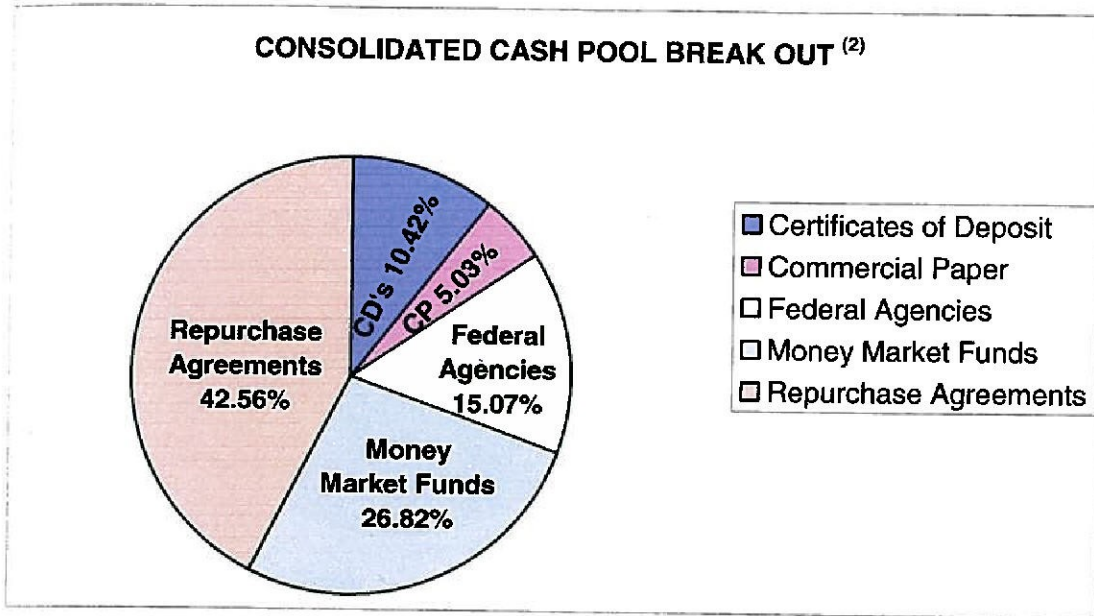
STRATEGY	NAV	% OF TOTAL <sup>(1)</sup>
Mixed	\$ 10,381,599,557	54.60%
MMKT Fund	8,631,016,925	45.40%

**Treasury Investment Pools/Programs by Investment**

--Over 40% of Pool 98, while 'Mixed' is actually in Cash & Cash Equivalent Investments

STRATEGY	NAV	% OF TOTAL <sup>(1)</sup>
Non - MMKT Fund	\$ 6,739,342,069	35.45%
MMKT Fund	12,273,274,413	64.55%

### Typical Cash & Cash Equivalent (C&CE) Asset Allocation (Table 3)



<sup>(2)</sup> Pie chart does not include Corporate Notes which are < 1% of the CCP

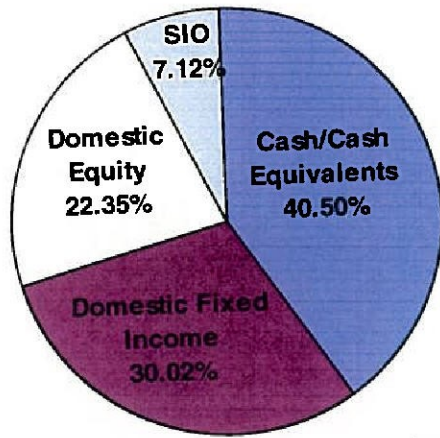
Very conservative overall:

- Weighted Average Maturity under 130 days
- Final Maturity not to exceed 13 months
- Complete details on page 25 of Treasury Investment Policy [www.patreaury.org](http://www.patreaury.org)



**Pool 98 – The Common Investment Pool Breakdown (Table 4)**

**POOL 98 ASSET ALLOCATION AS OF 4/30/08 <sup>(1)</sup>**



- Cash & Cash Equivalents (C&CE)
- Domestic Fixed Income
- Domestic Equity
- Strategic Investment Opportunities

<b>Asset Class</b>	<b>4/30/08 MV</b>	<b>Pool 98</b>
Cash & Cash Equivalents (C&CE)	3,687,626,599	40.50%
Domestic Fixed Income	2,733,106,114	30.02%
Domestic Equity	2,034,919,215	22.35%
Strategic Investment Opportunities	647,975,295	7.12%
Private Equity	2,016,497	0.02%
	<b>9,105,643,720</b>	<b>100.00%</b>

## 2007 Fees (Table 5)

### Pool 98 – Common Investment Pool

- Cash and Cash Equivalents and Strategic Investment Opportunities are managed internally by Treasury staff – no external management fees.
- Average externally managed assets for 2007 was approximately \$4.6 billion.
- Fees paid to external managers for 2007 was approximately \$15.5 million
- This is an average fee of 33 basis points.

### **POOL 98 INVESTMENT MANAGER FEES**

<b>INVESTMENT MANAGER</b>	<b>2007</b>
Allegiant (National City)	\$ 170,838
BlackRock	134,752
Blue Hill	125,001
Chartwell	485,774
CIM	244,570
Community Capital Mgmt (CRA)	78,793
Delaware	180,615
Emerald	328,341
Estabrook	279,948
Federated	184,423
Haverford Trust	64,160
Mesirow	135,360
Philadelphia Trust	726,553
Ryan Labs	326,632
Swarthmore	1,934,853
US Asset Management	509,542
Valley Forge Asset	5,317,765
Valley Forge Trust	2,394,729
Weaver Barksdale	1,903,653

TOTAL FEES 15,526,302

### TAP GSP

- Cash and Cash Equivalents are managed internally by Treasury staff – no external management fees.
- Average externally managed assets for 2007 was approximately \$1.0 billion.
- Fees paid to external managers for 2007 was approximately \$5.2 million
- This is an average fee of 49 basis points.

## Definitions

**Cash Equivalent.** A domestic security with a high enough level of liquidity to be considered as good as cash.

**Equities.** Common stock of a publicly traded company and securities convertible into common stock, as well as preferred stock, 144a securities, and warrants.

**Fixed Income Security.** A security that encompasses both **Adjustable Rate** or **Variable Rate Securities** and **Fixed Rate Securities**. An **Adjustable Rate** or **Variable Rate Security** is defined as a domestic fixed income security that is structured so that it provides a return in the form of periodic payments that may vary over the instrument's life, due to a change in interest rate, and a return of principal by maturity. A **Fixed Rate Security** is defined as a domestic security that provides a return in the form of periodic payments that are consistent and predetermined for the instrument's life, from purchase, and a return of principal by maturity.

**Intermediate-Term Security.** A security that matures in 13 months to ten years.

**Long-Term Security.** A security that matures in greater than ten years.

**Net Asset Value Per Share (NAVPS).** The total value of a pool's assets less liabilities, divided by the number of outstanding shares owned in the pool.

**Repurchase Agreement.** An agreement by the Treasury Department and/or its investment manager(s) to buy obligations of the United States Government and its agencies on a certain date from a bank or non-bank financial institution and then sell the same obligation of the United States Government and its agencies back to that particular institution on a specific date in the future at the same price plus an additional amount as agreed to by the parties. **Deliverable repurchase agreements** require the obligations of the United States Government and its agencies to be held in a Treasury controlled bank account during the term of the agreement. **Tri-party repurchase agreements** allow the obligations of the United States Government and its agencies to be held by an unaffiliated third party in trust during the term of the agreement.

**Short-Term Security.** A security that matures in 13 months or less.

**Whole Loans.** A term that distinguishes an investment that is an original (usually) mortgage loan from a pass through security.