



PSERS



TM

COMMONWEALTH OF PENNSYLVANIA
PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM

Traditional Investments / Due Diligence Policy



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Revision History

Traditional Investments DD Policy Established	March 6, 2020
Policy Revised	March 5, 2021



I. SCOPE

This Policy applies to investments with External Managers in the Traditional Investments Asset Classes within the Pennsylvania Public School Employees' Retirement System ("PSERS") Defined Benefit Fund ("The Fund").

II. PURPOSE

This Policy provides the broad strategic investment framework for the due diligence process of investments with External Managers in the Traditional Investments Asset Classes. The implementation of this policy is outlined in the procedure manuals as maintained by Investment Office Professionals (IOP) in Traditional Investments.

III. ROLES AND RESPONSIBILITIES

Roles and Responsibilities related to this Policy are identified within PSERS' Investment Policy Statement ("IPS").

IV. RISK MANAGEMENT

Traditional Investments lend themselves well to traditional quantitative measures of risk, such as standard deviation, benchmark Tracking Error, and drawdown, and of risk-adjusted return, such as Sharpe Ratio and Information Ratio. In addition to quantitative measures, qualitative considerations are also important for managing risk. PSERS seeks to identify and acknowledge the sources and types of risk inherent in each underlying investment strategy and in each External Manager during the due diligence (underwriting) process. The key components of the process are identified below.

V. DUE DILIGENCE (UNDERWRITING) PROCESS

Thorough due diligence (underwriting) serves three primary objectives:

- Develop an understanding of the External Manager, its organization and its investment strategy: Thorough due diligence allows IOP to develop a credible thesis for an External Manager's future success. Documented underwriting helps IOP to improve investment decisions over time by providing the basis for analysis of historical External Manager recommendations.
- Set appropriate performance expectations: External Manager allocations are made and sized based upon expected outcomes, the range of anticipated deviations from those expectations, and the expected interaction with other holdings and External Managers in the portfolio. Underwriting allows IOP to contemplate economic environments that are not reflected in a discrete historical data series.



- Provide context for External Manager retention/termination decisions: Over time IOP will likely be confronted with organizational and exposure changes by the External Manager including AUM growth, personnel turnover, strategy modifications, and new product introductions. Often these changes are natural evolutions that allow a manager to maintain historical success. Occasionally, they are precursors to underperformance. Knowledge gleaned through the underwriting process will provide the foundation for these decisions.

Implementation of this policy is comprised of the following elements:

- **Sourcing and Identification**
 - IOP identify potential External Managers through numerous sources, including internal efforts, Investment Consultants and peer institutions.
- **External Manager Interviews: Meetings, Calls and Negotiation of Terms**
 - Thoughtful structured interviews allow IOP to anticipate an External Manager's ex-ante performance by understanding the decision makers, their philosophies, organizational structures and motivations.
 - Fees and other pertinent business terms are negotiated.
- **Performance Analysis**
 - IOP analyze historical results to understand the merits of an External Manager's investment strategy and possible future outcomes, to compare those to other available options, and to determine an External Manager's correlation with other External Managers in the portfolio.
 - An External Manager's relative performance is assessed against relevant metrics, including peer rankings.
- **Document Review**

Items to be reviewed fall into the following categories:

 - Current Due Diligence Questionnaires, Placement Agent Policy, and presentation materials
 - Historical client letters and communications
 - Audited financial statements
 - Investment Management Agreement or Offering Materials (e.g. Private Placement Memorandum, Limited Partnership Agreement, Subscription Document)
 - Investment Consultant(s) Memoranda
- **Public Information Review**
 - IOP, in conjunction with the assigned Investment Consultant, gather and review information that is publicly available, including Form ADV, about the External Manager and key individuals at the firm.
- **Reference Calls**
 - IOP perform reference calls, e.g. former employers/colleagues, current investors, former investors, etc.
- **Operations Review and Due Diligence**
 - The assigned Investment Consultant conducts a full operational review and issues an Operational Due Diligence (ODD) memorandum.
 - IOP reviews the completed ODD memorandum.
 - PSERS' Operational Due Diligence Manager will also conduct an internal ODD review.



- **Investment Review and Due Diligence**
 - IOP prepare their memoranda of recommendation that address key aspects of the investment, generally including firm overview, market opportunity, portfolio fit, past performance, and identified risks.
 - The assigned Investment Consultant conducts a full investment review and issues an Investment Due Diligence (IDD) memorandum.
 - IOP review the completed IDD memorandum.
- **Allocation Implementation Committee (AIC) Review and Approval**
 - The AIC reviews the IOP and assigned Investment Consultant memoranda and supporting information. If the AIC and the CIO approve the recommendation, the recommendation will be made, where applicable, to the Board.
- **Preliminary Legal/Side Letter Negotiation**
 - IOP provide legal documents to PSERS' Office of Chief Counsel (OCC) and Investment Operations groups.
- **Board Approval (where applicable)**
 - The IOP and assigned Investment Consultant recommendation memoranda are provided to the Board in advance of the Board meeting for consideration at the Board meeting.
- **Contracting/Legal Negotiations**
 - Upon Board approval, the IOP coordinate final legal reviews with the OCC and Investment Operations groups. Identified matters will be addressed via a side letter when necessary. The side letter, unless otherwise approved by the Board, will detail PSERS-specific requirements, including but not limited to: compliance with PSERS' Placement Agent Policy, information collection requirements (e.g. ILPA or comparable template), disclosure of Pennsylvania political contributions, and a Limited Partners Advisory Board seat where applicable.
 - Once the contracts have been approved and executed by the OCC, IOP, and PSERS' Executive Office, the contracts are sent, if necessary, to the Office of Attorney General for review and execution.