



COMMONWEALTH OF PENNSYLVANIA
PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM

External Manager Due Diligence and Monitoring Policy



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Revision History

Non-Traditional Investments Due Diligence

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Traditional Investments Due Diligence

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Public Markets and Private Markets Due Diligence and Monitoring

Policies Combined, Renamed and Revised	August 16, 2024
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I. SCOPE

This Policy applies to investments with External Managers across both Public Markets Asset Classes and Private Markets Asset Classes of the Commonwealth of Pennsylvania, Public School Employees' Retirement System ("PSERS") Defined Benefit Fund (the "Fund").

II. PURPOSE

This Policy provides the framework for the due diligence (underwriting) of prospective External Managers. The goals of this framework are to:

- Develop an understanding of the External Manager, its processes and investment strategy.
- Generate performance expectations, identify the factors necessary to meet those expectations, and risks that may impede meeting those expectations.
- Ascertain portfolio fit.

This Policy also provides the framework for monitoring External Managers. The goals of this framework are to:

- Determine whether the External Manager's performance, strategy, processes, and portfolio fit are still within expectations determined when originally underwritten
- Escalate to a watchlist those Public Markets External Managers falling outside of those expectations (Note: Internal Managers shall also be subject to a watchlist).
- Report annually to the Investment Committee the utilization and status of any Private Markets use of delegated authority.
- Cease new investment and/or terminate those External Managers falling outside of those expectations and expected to remain so.

III. ROLES AND RESPONSIBILITIES

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

IV. DUE DILIGENCE (UNDERWRITING) FRAMEWORK

Investment Office Professionals (IOP) are responsible for adhering to a framework for underwriting External Managers. IOP should leverage the resources of the relevant Investment Consultant throughout the underwriting process when prudent.



A. External Managers

- **Sourcing and Identification**
 - IOP identify potential External Managers through numerous sources, including internal efforts, the relevant Investment Consultant, and peer institutions.
- **Manager Analysis and Manager Interviews: Meetings, Calls and Preliminary Negotiation of Terms**
 - Thoughtful and structured interviews allow the IOP to develop performance expectations and a portfolio fit assessment for a prospective External Manager by understanding the decision makers, their philosophies, organizational structures and motivations, and the resultant impact on performance.
 - Economic and other pertinent terms are negotiated to align the interests of PSERS and the External Manager.
- **Performance Analysis**
 - IOP and the relevant Investment Consultant analyze historical results to build conviction in the merits of an External Manager's investment strategy and the execution thereof. An External Manager's relative performance is assessed against relevant benchmarks, including peer quartile rankings and public market equivalent returns when applicable.
- **Document Review**

Items to be reviewed may include the following (Note: Not all of these will be applicable or available in all cases):

 - Due Diligence Questionnaires, Placement Agent Policy, and presentation materials.
 - Historical client letters and communications, including, where applicable, a sampling of capital call and distribution notices, performance reports and holdings reports.
 - Audited financial statements of current and/or predecessor funds or partnerships (Note: Not applicable to custodied Separate Account portfolios managed via an Investment Advisory Agreement).
 - Offering materials for funds and partnerships (e.g., Private Placement Memorandum, Limited Partnership Agreement, Subscription Document).
 - Proposed investment guidelines and investment advisory agreements for custodied Separate Accounts.
- **Public Information Review**
 - IOP, in conjunction with the assigned Investment Consultant, gather and review information that is publicly available, including Form ADV, concerning the External Manager and key individuals at the firm.



- **Reference Calls**
 - IOP perform reference calls. These may include former employers/colleagues, current investors, former investors, vendors, or investment partners (Note: Not all of these will be applicable or available in all cases).
- **Operational Review and Due Diligence**
 - The assigned Investment Consultant conducts a full operational review and issues an Operational Due Diligence (ODD) memorandum.
 - IOP review the completed ODD memorandum.
 - PSERS' Internal Operational Due Diligence Manager will also conduct an ODD review and summarize the findings in a memo to the AIC. The conclusions within the Memorandum will incorporate any standard ODD questions which the External Manager failed to answer.
- **IOP Recommendation**
 - IOP prepare 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.
- **Review and Approval by AIC and CIO**
 - The AIC confirms that PSERS' Office of Chief Counsel (OCC) has issued the necessary Placement Agent No Objection Opinion, and votes on all External Manager recommendations.
 - Upon receiving AIC approval, the matter is elevated to the CIO for final approval, and subsequent Board recommendation if applicable.
- **Preliminary Legal/Side Letter Negotiation**
 - IOP may provide legal documents to OCC depending on the targeted funding or closing date of the investment to commence legal negotiations.
- **Board Approval (where applicable)**
 - IOP and assigned Investment Consultant recommendation memoranda along with information necessary for Board members to assess possible conflicts of interest, including but not limited to known, relevant political contribution information, are provided to the Board in advance of the Board meeting.
 - The Board votes on the recommendation.
- **Final Legal Negotiations**
 - Upon Board approval, IOP coordinates final legal reviews with OCC. Certain matters will be addressed via a side letter and/or investment advisory agreement to obligate the External Manager to abide by all applicable and then-current PSERS Board Policies (e.g., Placement Agent Policy) or other requirements as may be required and



confirmed with OCC (e.g., disclosure of political contributions and the use of ILPA templates where applicable).

- Once the agreements have been approved and executed by OCC, IOP, and PSERS' Executive Office, the contracts are sent, if necessary, to the Office of Attorney General for review and execution.
- The Office of Attorney General (OAG) has delegated to PSERS execution authority for fully negotiated contracts that meet the requirements of the Office of Attorney General's delegation letter.
 - Fully negotiated contracts that do not meet the above criteria must be sent by OCC to the OAG for review and approval.

B. Co-Investments and Secondary Investments (excluding Private Markets PA Co-Invest Program)

Co-Investments and Secondary Investments in Private Markets are defined and specifically permitted in the Private Markets Asset Class Policy.

Co-Investments in Public Markets are specifically permitted in the Public Markets Asset Class Policy.

- **Sourcing and Identification**
 - IOP may be offered Co-Investments and Secondary Investments alongside existing External Managers.
- **Manager Discussions and Analysis**
 - IOP will engage in detailed discussions with the External Manager sponsoring the Co-Investment or Secondary opportunity to better understand the merits and risks of the opportunity.
- **Performance Analysis**
 - IOP analyze historical results to assess the merits of an External Manager's investment strategy and execution thereof.
- **Document Review**

Items to be reviewed may include the following (Note: Not all of these will be applicable or available in all cases):

 - Investment Committee Memorandum
 - Financial Models
 - Bank / Lender presentation
 - 3rd Party Investment Consultant Reports (i.e., quality of earnings)
 - Applicable Financial Statements
 - Offering Materials (e.g., Limited Partnership Agreement, Subscription Document)
 - Relevant investment and deal lead track records
 - Applicable legal formation documents and any other relevant legal documents.



- **Public Information Review**
 - IOP will gather and review information that is publicly available concerning the External Manager sponsoring the Co-Investment, the key individuals at the firm, and the Co-Investment entity.
- **IOP Recommendation**
 - IOP prepares a memorandum to the AIC that address key aspects of the investment, generally including an investment overview, market opportunity, portfolio fit, management track record, public information review, identified risks, External Manager concentration risk and Portfolio Co-Investment and Secondary Investment capacity; concluding with a formal recommendation.
- **Review and Approval by AIC and CIO**
 - The AIC reviews and votes on all Co-Investment and Secondary Investment recommendations. Upon receiving AIC approval, the matter is elevated to the CIO for final approval.
- **Contracting/Legal Negotiations (when applicable)**
 - Upon AIC and CIO approval, the IOP begins legal reviews with OCC. Certain matters will be addressed via a side letter when necessary.
 - The Office of Attorney General (OAG) has delegated to PSERS execution authority for fully negotiated contracts that meet the requirements of the Office of Attorney General's delegation letter.
 - Fully negotiated contracts that do not meet the above criteria must be sent by OCC to the OAG for review and approval.

C. Private Markets PA Co-Investment Program

Co-Investment opportunities located in Pennsylvania sourced from an existing External Manager will follow either the process outlined in Section IV. B. above, or will be assigned to the applicable Investment Consultant following the process outlined below.

Co-Investment opportunities located in Pennsylvania where PSERS does not have an existing External Manager relationship will be assigned to the applicable Investment Consultant following the process outlined below.

- **Consultant Recommendation**
 - PA Co-Investment Program opportunities are underwritten and recommended by the applicable Investment Consultant.
- **IOP Recommendation**
 - Reviews the Investment Consultant's recommendation and determines if it will be recommended to the AIC for approval.
- **Review and Approval by AIC and CIO**
 - The AIC reviews and votes on all PA Co-Investment Program recommendations.
 - Upon receiving AIC approval, the matter is elevated to the CIO for final approval.



V. MONITORING FRAMEWORK

The External Manager monitoring framework is comprised of the following elements:

Element 1: Reporting Review

IOP should review relevant External Manager reporting. This may include investor letters, performance, holdings and risk reports, financial statements, capital account statements, audits, Form ADV, ILPA reporting, and other PSERS-specific disclosures (Note: Not all of these will be applicable or available in all cases).

Element 2: Ethics and Compliance Affirmations

IOP should review any ethics and compliance affirmations from External Managers as required to be provided to PSERS in the governing legal documents. These may include:

- Annual affirmation of awareness of and compliance with PSERS ethics policies with regard to their interactions with PSERS and PSERS personnel
- Annual affirmation of compliance with PSERS rules, such as the prohibition on gifts
- Annual affirmation of compliance with required disclosures, code of conduct, and conflicts of interest by trustees, executives, and third parties

Element 3: Manager Meetings

IOP should participate in virtual or in-person meetings with each External Manager at least annually. This may be satisfied through attendance at Annual General Meetings (for Private Markets External Managers), Limited Partner Advisory Board meetings (for Private Markets External Managers), and/or manager update meetings with IOP. Typical areas to address include firm/team/strategy changes, portfolio review and performance, market outlook, and legal/compliance/operational updates.

Element 4: Investment Consultant Dialogue

Investment Consultant(s) should function as an extension of IOP with regard to External Manager monitoring. IOP will maintain an ongoing dialogue with the relevant Investment Consultant to discuss External Manager performance and any potential areas of concern.



Element 5: Investor Consents and Amendments

From time to time, External Managers may seek consents and/or amendments from Advisory Board Members or Limited Partners as contemplated in governing legal documents (including limited partnership agreements, investment management agreements, and side letters).

IOP (from a business perspective) and OCC (from a legal perspective) will work jointly, as necessary, to review the proposed consent/amendment and recommend approval or rejection.

On occasion, IOP may wish to initiate an amendment to the governing legal documents (i.e., fee structure, exposure thresholds, key persons) and will work jointly with OCC to effectuate such amendment. Amendments may need to be reviewed by OAG if they do not meet the OAG delegation letter requirements.

Element 6: Public Markets Watchlist

If IOP determines that a Public Markets External Manager has fallen outside of expectations as originally underwritten, IOP will place that External Manager on a watchlist. Additions to a watchlist will be communicated to the Board within the Investment Office Dashboard.

Similarly, if a Public Markets External Manager that is on a watchlist is determined by IOP to be back within expectations as originally underwritten, IOP will remove that External Manager from the watchlist and the Investment Office Dashboard.

A more detailed review of the External Manager lineup in relation to watchlist criteria, including updating any decision to terminate, will be reported to the Board semi-annually in consultation with the Investment Consultant.

Element 7: Public Markets Termination

IOP will prepare a memorandum of recommendation to the AIC addressing the rationale for termination, reduction, or disposition as well as the process, timeline, and costs.

The AIC reviews and votes on the recommendation. Upon receiving AIC approval, the matter is elevated to the CIO for final consideration.

Notwithstanding recommendations from the AIC, the CIO has authority and ultimate responsibility for manager termination decisions, for cause or otherwise.



In exercising the CIO's duty to act prudently, the CIO may accept or reject the recommendations of the AIC that PSERS appoint or discharge External Managers, forward recommendations to the Board to appoint External Managers or take direct action to discharge them, including for example selling interests in the secondary markets, following prior notification to the Board.

CIO will update the Board on any termination as described above in Element 6.

Element 8: Private Markets Utilization of Delegated Authority

IOP will provide an annual report to the Board of Private Markets utilization of delegated authority, including the following elements:

- Co-Investment and Secondary Investment authority and annual investment activity
- Continuing resolutions (i.e., mandates allowing staff to add new money to accounts upon AIC / CIO approval), associated performance of such mandates, and annual activity utilizing such delegated authority

VI. DEFINITIONS

All terms are defined within this document, other Policies (such as the Public Markets Asset Class Policy and Private Markets Asset Class Policy), or the IPS.