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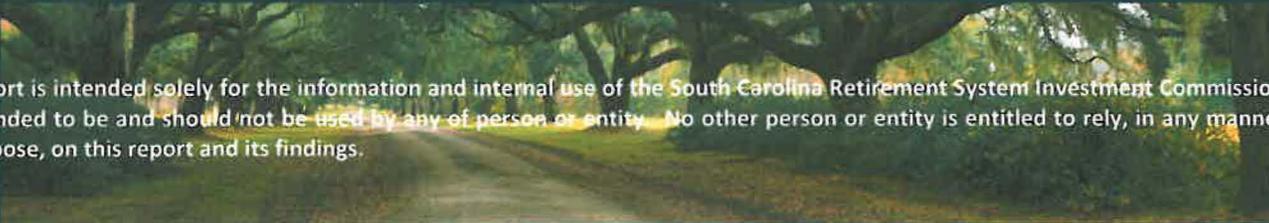


SOUTH CAROLINA RETIREMENT SYSTEM
INVESTMENT COMMISSION

SOUTH CAROLINA RETIREMENT SYSTEM INVESTMENT COMMISSION

“RSIC DUE DILIGENCE GUIDELINES” AND RELATED POLICIES ASSESSMENT

AUGUST 2012



This report is intended solely for the information and internal use of the South Carolina Retirement System Investment Commission, and is not intended to be and should not be used by any of person or entity. No other person or entity is entitled to rely, in any manner, or for any purpose, on this report and its findings.

Preface

Professional Standards

Our services were performed in accordance with the Statement on Standards for Consulting Services that is issued by the American Institute of Certified Public Accountants ("AICPA"). We provided to the South Carolina Retirement System Investment Commission (the "Commission" or "RSIC") our observations, advice, and recommendations. However, our services did not constitute an engagement to provide audit, compilation, review, or attestation services as described in the pronouncements on professional standards issued by the AICPA, and, therefore, we did not express an opinion or other form of assurance with respect to our services.

In addition, we did not provide any legal advice regarding our services nor did we provide any assurance regarding the outcome of any future audit or regulatory examination or other regulatory action; the responsibility for all legal issues with respect to these matters, such as reviewing all deliverables and work product for any legal implications to the Commission, will be the Commission's. It is further understood that the Commission has responsibility for, among other things, identifying and ensuring compliance with laws and regulations applicable to the Commission's activities and for establishing and maintaining effective internal control to assure such compliance. The Commission will have responsibility for reviewing and approving any reports and/or deliverables.

Our services may include advice and recommendations, but all decisions in connection with the implementation of such advice and recommendations shall be the responsibility of, and made by, the Commission. In connection with providing the services described herein, we shall be entitled to rely on all decisions and approvals of the Commission.

This report is intended solely for the information and internal use of the Commission, and is not intended to be and should not be used by any of person or entity. No other person or entity is entitled to rely, in any manner, or for any purpose, on this report and its findings.

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Executive Summary

ASSESSMENT OVERVIEW

Pursuant to the Statement of Work dated April 18, 2012, Deloitte & Touche LLP ("Deloitte & Touche" or "we") conducted an assessment of the overall control environment (i.e., policies, procedures and practices) that the Commission has put in place in the following three areas:

1. External Manager Due Diligence
2. Investment and Portfolio Valuations
3. Cross Trades¹

In connection with the Commission's strategic initiative to improve the processes related to the above-mentioned areas, we performed the following activities to assess the current infrastructure:

- Requested and read the policies, procedures and other supporting documentation that the Commission maintains in connection with the three areas noted above (a list of the documents obtained is contained within our workpapers)
- Conducted interviews with the acting Chief Investment Officer, those individuals responsible for overseeing each asset class: public equities; fixed income; private equity (including Strategic Partnerships); private debt; hedge funds; and real estate, and the legal team (a list of individuals interviewed in connection with this assessment is contained within our workpapers)
- Conducted walk-throughs of the workflows and processes, control activities, reporting and recordkeeping systems, and tools (e.g., questionnaires, checklists, and scorecards)²

SUMMARY OF IN-SCOPE AREAS

We understand that the Commission has engaged the services of a number of external investment managers and entered into a number of Strategic Partnerships (collectively, the "External Managers") in connection with the management of the pension assets held in trust for the South Carolina Retirement

¹ Cross trades are those transactions within a Strategic Partnership whereby an investment in one fund is transferred (i.e., crossed) to another underlying fund of the Strategic Partnership. Insofar as the Commission is not directly responsible for initiating and implementing these transactions, the assessment of the procedures and practices related to cross trades are addressed in connection with the Commission's due diligence procedures and the oversight of the Strategic Partnerships. Accordingly, there are no separate findings and recommendations specific to cross trades within this report.

² As of the date of the conclusion of the fieldwork (June 5, 2012), the Commission was still in the process of developing, enhancing and/or implementing certain processes and systems used in connection with administering its policies and procedures across the three areas covered within this assessment.

System ("SCRS") and certain other governmental defined benefit plans.³ A key control that the Commission is looking to implement in connection with the management and oversight of the External Manager relationships is the *RSIC Due Diligence Guidelines* (the "*DD Guidelines*"), which includes, among other things, guidelines for new manager selections, document collections and reviews, preliminary and on-site manager meetings, manager approvals, and on-boarding procedures.⁴ To enhance the new manager selection process and the oversight of the current External Managers, the Commission is looking to expand the scope of the **External Manager Due Diligence** program to include the valuation and, as applicable, the cross-trading practices of the External Managers.

Although the Commission is not directly responsible for the **Investment and Portfolio Valuations**, it has ultimate responsibility for ensuring the accurate reporting of the plan investments in the financial statements. To this end, we looked at the procedures and control activities that the Commission has in place to oversee the valuation practices, including the governance structure, methodologies, pricing models, and underlying assumptions of the External Managers.

As noted above, certain External Managers may engage in **Cross-Trading** activities, which involves the transfer of assets between two funds of a Strategic Partnership. Because such transactions raises potential conflicts of interest, including valuation issues, the Commission is looking to expand the due diligence procedures to include the monitoring and oversight of these types of transactions.

SUMMARY OF RECOMMENDATIONS

Based on our assessment of the three aforementioned areas, we have the following recommendations for enhancing and strengthening the overall control environment and due diligence program for the Commission's consideration:

- **Due Diligence Procedures**
 - Formally adopt and implement the *DD Guidelines*, including guidelines and procedures related to co-investment opportunities and investments with and in Strategic Partnerships
 - Supplement the *DD Guidelines* with on-going monitoring and due diligence procedures, including operational due diligence procedures to support the overall due diligence program
 - Complete development of the new forms and tools such as the Investment Management Solicitation Form, Sourcing and Conflicts Disclosure Form, Due Diligence Database, and staff training materials

³ We understand that, as of the date of this report, the Commission maintains relationships with over 100 external investment managers across the various asset classes and 13 Strategic Partnerships.

⁴ In addition to the *DD Guidelines*, the November 2011 *South Carolina Retirement System Investment Commission Statement of Investment Objectives and Policies* provide further guidance with regard to the manager search, screening, approval, and termination procedures.

- Establish and implement a framework for developing External Manager risk-profiles and sample tools such as due diligence questionnaires, request for documentation, meeting agendas, and compliance certifications
- Review periodically (and report to the Audit Committee) adherence to the initial and on-going due diligence procedures
- **Valuation Procedures**
 - Expand the scope of the initial and on-going due diligence procedures to include the monitoring and oversight of the External Managers’ valuation practices
 - Develop and implement documentation standards to evidence and support the due diligence processes
 - Conduct a risk assessment of the External Manager’s investment activities to develop, among other things, an understanding of the investment strategy, the instruments used to implement the strategy, and any assumptions underlying the valuation of those instruments

REPORT FORMAT

This report contains the following three sections, which provide, among other things, sample tools and frameworks that the Commission may wish to consider as it continues to manage and oversee the pension assets.

- I. **Assessment results and findings**, including a high-level summary of the Commission’s current due diligence process, opportunities to enhance the practices related thereto, and recommendations for management’s consideration
- II. **Sample due diligence framework**, including sample tools used in connection with the due diligence framework
- III. Initial due diligence and on-going monitoring procedures related to the **valuation of alternative investments**, including leading practice considerations

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I. Assessment Results and Findings

EXTERNAL MANAGER DUE DILIGENCE

Overview

We understand that the Commission is in the process of adopting and implementing the procedures contained in the *DD Guidelines*.⁵ In addition, the Commission is planning to enhance the due diligence process by establishing and developing a number of new forms and tools. They include the following:

- Investment Management Solicitation Form
- Sourcing and Conflicts Disclosure Form
- Due Diligence Database
- Investment Memo and Due Diligence Report
- Staff training materials

To add more structure and discipline to the due diligence process, the Commission is planning to institute new standardized documentation and file retention requirements through the use of meeting notes and new Investment Folder and Strategic Partnership templates. Furthermore, the Commission is establishing guidelines for analyzing quantitative and qualitative factors,⁶ as well as operational due diligence considerations associated with the potential investment.⁷

⁵ The Commission last amended the *DD Guidelines* on January 26, 2012 and conducted a training session related thereto for the Commission staff. The Commission expects to finalize and adopt the *DD Guidelines*, along with on-going monitoring and due diligence procedures, in 2012. After the Commission implements the *DD Guidelines* and the on-going monitoring procedures, Internal Audit and Compliance ("IA/C") should look to periodically audit (and report to the Audit Committee) compliance with the initial and on-going due diligence procedures. In connection with auditing compliance with the procedures, other related areas that IA/C may wish to review include the following: adherence to investment strategies (e.g., style drift); investment allocations; investment performance and dispersion analysis; maintenance of supporting documentation (including meeting minutes, investment memos and reports); contractual agreement reviews and approvals; and record retention practices.

⁶ Quantitative factors analyzed include: historical performance; historical attribution; historical risk metrics; historical correlation analysis; and historical peer group rankings. Qualitative factors analyzed include: investment philosophy and process; quality of people; attractiveness of investment themes; risk philosophy and controls; reasonableness of costs and terms; compliance processes; asset valuation methodologies; reference checks; and pending legal/regulatory matters.

⁷ Improving its operational due diligence procedures is a key area of focus for the Commission. To this end, the Commission is looking to leverage its relationship with and the resources of the Strategic Partnerships, enhance the education and training of its staff, and hire additional resources. As outlined in the *DD Guidelines*, the following is a partial list of areas addressed in connection with the operational due diligence process: service providers (e.g., prime brokers, custodians, administrators, accounting firms, and law firms); concentration limits; disaster recovery; expenses; key man provisions; leverage and financing sources and terms; management of conflicts of interests; organizational structure; personal trading practices; and regulatory oversight.

The on-site component of the due diligence process,⁸ which is designed to gain a more thorough understanding of the prospective manager's investment philosophy, the quality of investment team and other key professionals, costs and risks associated with the potential investment, and the controls in place to mitigate those risks, includes, among other things, the following steps:

- Conducting a pre-meeting with the prospective investment manager at the offices of the Commission
- Analyzing the legal documents⁹ and the manager's policies and procedures¹⁰
- Meeting with the manager at its offices and discussing the manager's portfolio management and investment strategy, operations, trading practices, compliance environment, risk management practices, use of internal and/or external counsel, and organizational structure
- Providing the legal team with a summary of the key business terms, potential issues, and estimated timelines (interim- and final-closings)
- Preparing an investment memo and due diligence report for the Investment Committee and Investment Commissioners

Results and Findings

While the Commission has made progress towards enhancing and improving its due diligence processes, based on our meetings and walk-throughs of the due diligence procedures, the Commission has not consistently maintained or followed the procedures outlined in the *DD Guidelines*. In connection with the Strategic Partnership files, we were expecting to find the following documents and materials:

- NEPC due diligence report, including recommendation of the Strategic Partnership(s)
- Internal analyst materials and due diligence report
- Meeting minutes documenting the approval of the Strategic Partnership investment
- Contractual agreement and related legal documents with the Strategic Partnership
- Reconciliation of fees paid to contracted amounts
- Performance evaluation
- Current NEPC evaluation
- Audited financial statements
- Funding history and annual investment plan
- Valuation calculations

⁸ Note: this assessment did not address the approval and on-boarding processes contained within the *DD Guidelines*.

⁹ E.g., offering documents, limited partnership agreements, side letters, audited financial statements and Form ADV (as applicable).

¹⁰ E.g., compliance manual, Code of Ethics, trading policy, proxy voting policy, valuation policy, and investment allocation policy.

Our analysis showed that all 13 Strategic Partnership files were missing one or more of the above-noted documents.

As noted above, the Commission has a number of strategic initiatives underway to enhance and improve its due diligence process. One such measure is the development of a due diligence database to serve as a central repository of the data and information collected in connection with the initial and on-going due diligence processes. The Commission, however, indicated that it currently does not have the technology resources to complete the database.¹¹ In addition, the Commission indicated that it does not have the staff or resources to address the operational due diligence areas noted within the *DD Guidelines*. The Commission further indicated that on-going due diligence procedures are not formally documented.

Recommendations and Enhancement Opportunities

The sample due diligence framework in section II outlines an approach the Commission may follow to enhance its current initial due diligence process and supplement this process with the on-going monitoring and due diligence procedures. In addition to the sample framework, the following are additional areas for focus/consideration that the Commission may wish to incorporate into its due diligence program—both initial and on-going due diligence procedures.¹²

Investment Due Diligence

- Overview of strategy and portfolio construction processes
 - Sector and geographic exposures
 - Leverage: net and gross exposures
 - Average position size
 - Hedging techniques
 - Fixed income portfolio characteristics (e.g., duration/yield/credit quality)
- Investment process and idea generation (e.g., is the security selection consistent with articulation of the investment process)
- Portfolio constraints (e.g., sector/market/position/leverage limits)
- Liquidity (days to liquidate)
- Value proposition and competitive edge
- Targeted returns, best- and worst-case scenarios, and strengths/weakness of strategy

¹¹ As the time of our assessment, the Commission was in the process of issuing a request for proposal to find a third-party document management solution.

¹² The implementation of the recommended enhancements to the initial and on-going due diligence procedures may require the Commission to supplement its current staff with additional operations, compliance, and technology resources (i.e., subject matter specialists) that have practical experience with analyzing and assessing processes, workflows, control activities, and systems germane to each of these respective areas.

- Composite returns
- Strategy shifts and smoothing
- Performance attribution
- Impact of leverage on returns

Operational Due Diligence (and Risk Controls)

- Cash movement and controls (e.g., separation of responsibilities and independence checks; involvement of the Chief Compliance Officer ("CCO"); and robustness of the compliance program, including level of compliance resources)
- Trade processing and reconciliations, including CCO oversight and review of policies and procedures
- Regulatory compliance, including interactions with the regulator(s), regulatory filings, and management of regulatory examinations
- Review of marketing materials and other investor disclosures
- Risk controls
 - Procedures for assessing and managing market risk, liquidity risk, and counterparty risk
 - Stress testing and scenario analysis (best- and worst-case)
 - Volatility and value at risk
 - Portfolio liquidity vs. investor liquidity
- Major counterparties and exposure thereto
- Frequency of assessments and testing performed (e.g., quarterly testing of investment allocations)
- Issue identification, escalation, reporting, and resolution procedures

Compliance Due Diligence (and Conflicts of Interest Considerations)

- Tone at the top and compliance culture vis-à-vis robustness of the compliance program
 - Experience and tenure of the CCO
 - Authority of the CCO within the organization
- Expense allocations
- Related party transactions or use of affiliated brokers and/or other service providers
- Number of prime brokers
- Best execution

- Side letters and varying levels of transparency and access to information
- Error correction policies
- Side-by-side trading and allocation procedures
- Access to annual compliance reviews and/or regulatory examination letters

Technology Due Diligence

- Systems: portfolio management; trade order management; and investment compliance
- Systems security measures: redundancy; data storage; firewalls; and disaster recovery

INVESTMENTS AND PORTFOLIO VALUATIONS

Overview

As previously noted, the Commission has engaged the services of a number of External Managers to manage the pension assets held in trust for SCRS, and while the Commission may look to the External Managers to perform the valuation calculations, the Commission is ultimately responsible for the valuations of the investments reported in the plan's financial statements, which SCRS prepares.¹³ To ensure that the plan investments are properly valued, the Commission should have sufficient information to evaluate and independently challenge the valuations use by the External Managers.¹⁴ Accordingly, the Commission should take reasonable steps to gain an understanding of the following with regard to the management of its investment portfolios:

- Underlying investment strategies, including investment process and idea generation, capacity constraints (if any), sustainability of the strategies, historical performance, liquidity terms, portfolio turnover, and portfolio transparency

¹³ See, *AICPA Alternative Investments – Audit Considerations: A Practice Aid for Auditors*, which states in relevant part, "management of the investor entity is responsible for the valuation of alternative investment amounts as presented in the investor entity financial statements...and that responsibility cannot, under any circumstances, be outsourced or assigned to a party outside of the investor entity's management."

Pursuant to the October 20, 2011 Memorandum of Understanding entered into by the SCRS and the Commission, the SCRS is responsible for preparing the "required investment schedules, note disclosures and required supplemental information during the preparation of financial statements for the pension trust funds."

¹⁴ On February 22, 2007, the President's Working Group on Financial Markets ("PWG") released its *Agreement among PWG and U.S. Agency Principals on Principles and Guidelines regarding Private Pools of Capital* (text available at http://www.treasury.gov/resource-center/fin-mkts/Documents/hp272_principles.pdf). In the guidelines, PWG stated that, "Investors in private pools of capital should obtain accurate and timely historical and on-going material information necessary to perform due diligence regarding the pool's strategies, terms, conditions, and risk management, thereby enabling such investors to make informed investment decisions. The PWG further stated, "Investors in a private pool of capital should carefully evaluate the strategies and risk management capabilities of the private pool to ensure that the pool's risk profile is compatible with their own appetites for risk."

- Types of instruments and techniques used to implement the investment strategy, including derivatives, long/short positions, and leverage caps
- Valuation methods and assumptions used to value the underlying investments (especially for those investments where readily determinable market values do not exist)

Results and Findings

The Commission currently does not maintain initial/on-going due diligence and financial reporting controls to support the valuations of the External Managers.¹⁵ Because valuation of the investments, alternative or otherwise, is the responsibility of management, the Commission should consider developing and implementing procedures and controls to ensure the integrity and accuracy of the valuations provided by the External Managers.

Recommendations and Enhancement Opportunities

In addition to the initial and on-going due diligence procedures set forth under section III, the Commission may wish to consider the following three recommended enhancements to its investments and portfolio valuation practices. The enhancements, which incorporate the guidance contained in Financial Accounting Standards Board, *Accounting Standards Codification Topic 820, Fair Value Measurements and Disclosures* ("ASC 820"),¹⁶ are intended to assist with the identification of fluctuations in valuations of the investments and support the Commission's risk mitigation efforts in connection with its financial reporting obligations.

Recommendation 1: Documentation and Other Evidence to Support the Due Diligence Process

¹⁵ In addition, the Commission does not maintain controls procedures/controls for overseeing the cross-trading activities and valuation practices of those investment managers managing the Strategic Partnerships.

¹⁶ ASC 820 (formerly Statement of Financial Accounting Standards No. 157 – Fair Value Measurements) provides guidance for valuing investments. In addition, ASC 820 offers a framework for defining the following:

- Hierarchy of estimates and factors to consider in estimating fair value if the volume and level of market activity for an asset or liability has decreased and transactions in a particular market are not orderly;
- How to consider inputs into valuation analysis;
- Valuation techniques, including assumptions used to price investments; and
- Financial statement disclosures.

(text available at <http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175823558998&blobheader=application%2Fpdf>).

The *AICPA Alternative Investments – Audit Considerations: A Practice Aid for Auditors* reinforces the need for management to maintain supporting documentation to evidence its due diligence efforts in connection with overseeing the valuation practices of those investment managers to whom management has delegated certain investment management responsibilities. The following are examples of documentation to evidence management controls:

- Written due diligence memos with appropriate review and approvals indicated
- Formal due diligence checklists (i.e., discussion topics), questionnaires, meeting agendas
- Meeting minutes and/or summaries related to investment approvals
- Formally adopted and approved written policies and procedures
- Written standard operating procedures related to:
 - Reconciliation of audited financial statements to recorded balances
 - Roll-forward of audited balance from the fund's year-end to the investor's year-end
 - Comparison of actual returns to benchmark returns, including explanation of significant variances
- Written notes on valuations documenting understanding the manager's valuation process and conclusions
- Memo explaining rationale for accepting the manager's valuation and/or adjustments

Recommendation 2: Risk Assessment

Alternative investments present many unique risks, the management of which requires understanding the attributes, structures and strategies associated with the investments. The following are risk considerations in connection with assessing risks related to alternative investments:

- Management, governance, and service providers
 - Quality and experience of fund management (e.g., is this a new or established investment manager; does the manager demonstrate that it is qualified to execute the strategy)
 - Role and effectiveness of fund governance (e.g., is there an advisory committee or other governing body)
 - Quality of service providers (e.g., are the auditors reputable; do have the requisite knowledge and experience given the nature and complexity of the fund and investments)
- Strategy, structure, and key terms
 - Nature, complexity, and liquidity of the strategy (e.g., are prices readily availability and transparent; what are the risks and complexity of the instruments in the portfolio)
 - Nature of the liquidity terms (e.g., is the fund's liquidity consistent with management's liquidity needs; what is the subscription/redemption frequency)

- Complexity of structure and key terms (e.g., management fee, incentive fee/allocation, carried interest, hurdle rate/preferred return, high-water mark, claw-back provisions, loss carry-forward, side letters, and opt-out provisions)
- Transparency and reporting
 - Nature and quality of transparency (e.g., timeliness of reporting; access to portfolio holdings, books and records, portfolio management, and operations professionals)
 - Quality of financial reporting (e.g., are the accounting policies and procedures consistent with industry practice; is the fund's year-end coterminous with the reporting year-end)
- Internal controls
 - Adequacy of infrastructure, personnel and general controls (e.g., what is the quality of the accounting and operational personnel; are there written policies and procedures; does the fund manager maintain adequate oversight over external service providers)
 - Design and effectiveness of valuation policies and procedures (e.g., are there comprehensive valuation policies and procedures; is there an oversight committee; what is the degree of independence in the valuation process)
 - Quality of risk monitoring (e.g., what types of monitoring, reporting, escalation, and resolution processes exist; are "stress tests" performed on a regular basis; are there policies and procedures to measure exposure to leverage)
 - Impact of regulatory compliance matters (e.g., have there been any regulatory examinations and what were the results)
 - Impact of legal and tax matters (e.g., is there any pending lawsuits or litigation involving the investment manager)

Recommendation 3: Training

Similar to the due diligence process, the team responsible for monitoring and overseeing the valuation practices of the External Managers should have the requisite level of investment, finance, and accounting knowledge to understand the nature and complexities of the investment portfolio, as well as experience with evaluating and monitoring alternative investments. To this end, the Commission should consider developing a training program supported by systems to monitor, oversee, and report on the alternative investments.

II. Sample Due Diligence Framework

OVERVIEW

The following is a sample due diligence framework that the Commission may pursue to strengthen and enhance the processes it currently has in place to identify, select and monitor the investment managers that will be responsible for or are at the present managing pension assets on behalf of the Commission.¹⁷ As depicted in the illustration, the framework consists of four interconnected assessment (i.e., due diligence) areas—investments, operations, compliance and technology—and follows a disciplined and systematic series of steps that includes, among other things, research, committee reviews, on-site visits, and final approvals/decisions. The framework also incorporates a risk-based approach to facilitate the allocation and deployment of resources in conducting the due diligence visits.



Although the framework follows a systematic process, which includes a standard document request list, meeting agenda and due diligence questionnaire, among other things, the Commission should (and will need to) customize the approach depending on the facts and circumstances specific to the investment manager (e.g., investment strategy, asset class, product set, size or assets under management—“AUM”). In addition, while the objectives, information sought, level of detail and the analyses performed may vary depending on whether the due diligence is in connection with screening a prospective new investment manager (initial due diligence) or monitoring the investment activities of an existing manager (on-going due diligence), the four assessment areas remain constant and the framework focuses on the governance structure, policies, and control activities that the managers have put in place to manage risks inherent to the managers’ specific business models and investment activities.

Execution of the framework vis-à-vis the due diligence visit involves input from investments, operations, compliance and technology subject matter specialists to assess whether the investment manager’s business model: governance structure; operations; compliance environment; and technology infrastructure, aligns with the manager’s investment activities. To this end, the due diligence team responsible for conducting the assessment should include resources with a working knowledge or practical understanding of the following elements of the manager’s investment operations:

- The investment strategy, including the types of instruments used to implement the strategy

¹⁷ This includes co-investment opportunities, as well as investments with and in Strategic Partnerships. The due diligence in connection with these investments may involve different criteria, objectives and guidelines related to manager selections, allocations, reporting, valuation, and monitoring.

- The operational infrastructure and internal controls
- The compliance environment and the compliance policies and procedures that the manager has adopted pursuant to the applicable regulatory requirements
- The technology infrastructure in place to facilitate and support the manager's investment operations and activities

Whether executed in connection with an initial or on-going due diligence visit, the due diligence framework assesses the history of the firm, ownership structure, firm governance, compensation and retention incentives, succession planning, turnover of key professionals, investor composition, and client gains and losses, and AUM growth/decline over time. In addition, the framework broadly considers the following key matters and topics of focus under each of the four areas (see **SAMPLE TOOLS** for additional details regarding potential due diligence discussion topics).

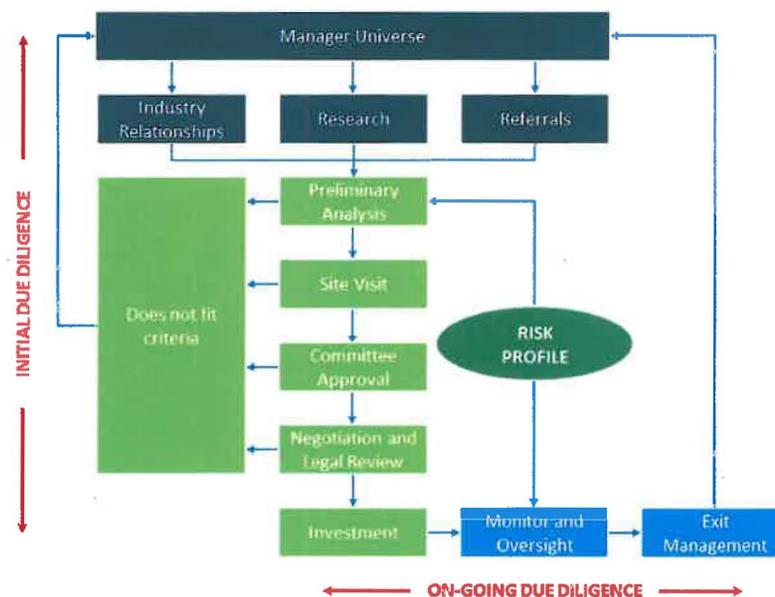
- **Investments Due Diligence**
 - Investment philosophy and process, including portfolio construction, research capabilities, and risk management
 - Composition of the investment team, including background and biographical information for key investment professionals
 - Product offerings and investment vehicles
 - Portfolio constraints and limitations
 - Historical returns, comparison to indices, relative performance versus peers, and risk metrics
- **Operational Due Diligence**
 - Operational workflows and processes to support the investment and trading activities of the investment manager
 - Middle- and back-office operations, including, as applicable, trade confirmations and settlements, portfolio accounting, internal and external reporting, performance calculations, and corporate actions
 - Valuation processes/controls (e.g., mark-to-market, fair valuation, and third-party review)
 - Net asset value ("NAV") computations, including any NAV restatements
 - Management of third-party service providers (e.g., pricing agents, custodians, fund administrators, prime brokers, and appraisers)
 - Maintenance of books and records
 - Internal controls, including operational risk management practices, testing protocols, and internal audits (as applicable)
- **Compliance (and Legal) Due Diligence**
 - Oversight responsibilities of the CCO, including administration of the compliance program (i.e., compliance policies and procedures) and the Code of Ethics
 - Compliance with contractual agreements, including investment management agreements ("IMAs"), offering documents, and limited partnership agreements ("LPAs")

- Management of conflicts of interest (e.g., affiliated transactions, best execution, soft dollar arrangements, allocation of investment opportunities, proprietary accounts, side-by-side management, side letter arrangements, and personal securities transactions)
- Investment compliance and error correction procedures
- Fee structures (management and incentive) and other key terms: most favored nations clauses; lock-ups; gates; and suspension rights
- Counterparty management, related party transactions and use of affiliated brokers (as applicable)
- Maintenance and administration of information barriers
- Preparation, review and approval of marketing materials, pitch books, and other investor disclosure documents
- Regulatory compliance, including interaction with the regulators, regulatory filings, and management of regulatory examinations
- **Technology Due Diligence**
 - Technology architecture, including integration with third-party platforms, systems and applications
 - Systems security measures (e.g., firewalls, physical and logical access controls, and network/application maintenance)
 - Change management protocols
 - Business continuity and disaster recovery planning and testing

DUE DILIGENCE PROCESS

Risk Profile

The decision-flow depicts the typical steps in the initial, as well as, the on-going due diligence processes, which includes developing a risk profile of the prospective new investment manager(s) or the investment manager(s) currently managing the pension assets. As one of the initial steps in the due diligence process, the risk profile is designed to facilitate the efficient allocation and deployment of resources in connection identifying, selecting, and monitoring investment managers. The risk profile is a combination of quantitative and qualitative measures. As noted in the first of the following two tables, quantitative measures include certain performance triggers such as absolute returns, returns relative to a benchmark and/or peer group, tracking error, and standard deviation. Qualitative risk factors or trigger events include, among other things, auditors’ opinions in connection with the financial statements, turnover of key professionals, client gains/losses, change in key service provider, change in ownership structure, and pending regulatory or litigation matters. The manager’s risk profile



determines the type, frequency, and scope/length of the due diligence process (e.g., the Commission may limit the due diligence activities for “low-risk” managers to telephonic conversations, obtain additional information through questionnaires or controls assessments reports—SSAE No. 16 reports—for “medium-risk” managers, and conduct more frequent in-person site visits for “high-risk” managers).

QUANTITATIVE PERFORMANCE TRIGGERS										
ASSET CLASS	The return performance relative to the benchmark is within ___% (3 mths, 1, 2,3, 5 years); threshold should vary based on fund mgmt - active mgt +/- 5%, passive mgt +/- 3%	The absolute return performance is negative for more than ___ periods over the prior 12 month period.	The return performance relative to that of peer funds is within ___% [s/be over a longer period of time]	Manager Tracking Error at 1, 3, 5, and 10 yr is < ___ for passively managed fund or > ___ for actively managed fund	Standard Deviation is more than the bench mark at 1, 3, 5, 10 yr indicating excess returns have been achieved with more volatility	Current value of fund is > ___% of Total Plan Assets	Current value of fund is > ___% of Total Asset Category	RSIC asset investment (ownership) > 15% of Total fund value	Absolute value (on NAV basis) is not drawn down > 20% over a rolling 3 mth period or calendar quarter	Absolute value (on NAV basis) is not drawn down > ___% quarter over quarter
PUBLIC EQUITY	Applicable	Not Applicable	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable to commingled funds*	Not Applicable	Not Applicable
FIXED INCOME	Applicable	Not Applicable	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable to commingled funds*	Not Applicable	Not Applicable
GAA	Applicable	Not Applicable	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable to commingled funds*	Not Applicable	Not Applicable
HEDGE FUND	Not Applicable	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable to commingled funds*	Applicable	Applicable
COMMODITIES	Applicable	Not Applicable	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable to commingled funds*	Not Applicable	Not Applicable
PRIVATE EQUITY	Applicable	Not Applicable	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable to commingled funds*	Not Applicable	Not Applicable
PRIVATE DEBT	Applicable	Not Applicable	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable to commingled funds*	Not Applicable	Not Applicable
REAL ESTATE	Applicable	Not Applicable	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable to commingled funds*	Not Applicable	Not Applicable

* Not separately managed

ASSET CLASS	QUALITATIVE RISK FACTORS/TRIGGER EVENTS							
	Manager has provided unqualified, audited financial statements for the most recent period	Manager's external auditor is included in the "Reputable Firm" listing.	Manager client base(\$ assets) has increase by ___% decreased by ___% over ___ time period (Should be measured over multiple time periods, with different percentages for the respective time periods)	Manager client base(# of clients) has increase by ___% decreased by ___% over ___ time period (Should be measured over multiple time periods, with different percentages for the respective time periods)	Manager has experienced Key Employee turnover in the past ___ period	Manager has experienced an irregular change in a major service provider	There is unfavorable legal or regulatory issues pending	Manager has experienced a change in ownership or control
PUBLIC EQUITY	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable
FIXED INCOME	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable
GAA	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable
HEDGE FUND	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable
COMMODITIES	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable
PRIVATE EQUITY	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable
PRIVATE DEBT	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable
REAL ESTATE	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable

Initial Due Diligence

The objective of the new manager search process (i.e., initial due diligence) is to develop a thorough understanding of the prospective investment manager’s organizational structure, including the people, process, and technology (collectively, the “infrastructure”) designed to support the manager’s investment process

and activities. The initial due diligence begins with the collection and evaluation of information from a wide range of sources, including, but not limited to, industry relationships/contacts, proprietary research, and referrals to identify potential investment opportunities with select investment managers. After researching and screening the universe of available investment opportunities, the preliminary analysis involves a high-level review of the investment manager's infrastructure, investment philosophy and process, portfolio positions, valuations, risk metrics, and historical investment performance to make an initial assessment of the investment opportunity and to ensure that there are no obvious "deal breakers" (i.e., reasons and/or concerns for moving forward with the investment) and culminates in an investment memo and recommendation for the investment committee's (or governing body's) consideration.¹⁸

After the preliminary analysis and based on the committee's decision, the initial due diligence process would involve the following steps:

- Conducting preliminary conference calls with the first round of prospective managers to develop a more in-depth understanding of the managers' organizational structure (including investment team), investment strategy and products, investment process, performance results, and control environment to identify a shorter list of managers from which to conduct in-person site visits
- Requesting and obtaining, from the "short-list" of managers, certain information and documentation, including completed due diligence questionnaires¹⁹
- Analyzing the advance materials to identify areas of focus (e.g., repeatability of the investment process, attribution, style drift, worst 12-month performance) in connection with the site visit²⁰
- Conducting meetings/interviews with the senior investments, operations, compliance, and technology professionals and conducting walk-throughs with the process owners across each of the assessment areas
- Preparing an investment report summarizing the results of the site visit²¹ and providing an investment recommendation for the committee's consideration²²

¹⁸ To facilitate the analysis, reporting, and storage of information/data collected in connection with the research and screening of prospective investment managers, organizations such as the Commission will typically use proprietary or third-party document management systems. Although the Commission currently has an initiative underway to identify a third-party vendor to provide a technology solution, this assessment did not include assessing the Commission's systems selection initiative.

¹⁹ We understand that the Commission currently uses asset class-specific questionnaires in connecting with its initial due diligence process (see **Appendix A: Documents Obtained** for a description of the due diligence questionnaires).

²⁰ The committee may decide to take no further action or decide to move forward and continue the due diligence process, which may involve in-person meetings and/or additional on-site activities to confirm the team's understanding of the overall control, key operational processes, and resources to support the investment operations. These steps may include requesting and analyzing additional information and documentation (e.g., due diligence questionnaire, audited financial statements, compliance manual, offering documents) and identifying potential areas of concern to focus on while on-site.

Should the committee approve of and decide to move forward with the investment, the due diligence team would conduct the necessary background checks on the manager's key professionals, including principals, directors, officers, and investment professionals. As a final stage of the initial due diligence process, the legal team would negotiate the contractual terms, including any investment restrictions and guidelines, with the investment manager. Thereafter, the operations team would make the necessary arrangements to transfer the funds to the investment manager.²³

On-going Monitoring and Due Diligence

The on-going monitoring and due diligence procedures serve as an extension of the initial due diligence process and supplement the manager information obtained in connection with the screening of prospective new managers and the selection thereof. As with the initial due diligence process, on-going due diligence covers the four core assessment areas, but the focus and objectives may differ depending on the investment manager's risk profile (i.e., quantitative and qualitative measures), the responses to the due diligence questionnaire, and changes to the manager's infrastructure, including ownership control and market events.

Similar to the initial due diligence process, execution of the on-going due diligence procedures involves input from investments, operations, compliance, and technology subject matter specialists to assess the manager's investment processes and operations and ensure alignment with the manager's traditional long-only, hedge fund, or private market strategies. The due diligence team would meet with senior management, as well as the process owners, and conduct walk-throughs of the key operating procedures and control activities (e.g., trade processing, investment compliance monitoring, surveillance activities, regulatory filings/reporting, recordkeeping, valuations, portfolio accounting, reconciliations, month-end NAV packages, and disaster recovery).²⁴

²¹ Topics generally covered in the investment report may include: manager history and description; strategy overview; summary of investment considerations (merits) and concerns; investment process and portfolio construction; performance and portfolio analysis; risk management (including operations and control environment); investor composition and investment team descriptions; peer analysis and correlation; liquidity analysis; reference checks; identification of events that may trigger a subsequent review of the manager; and final recommendation.

²² Each member of the due diligence team outside of the investments area should have the ability to veto the investment decision based on the appropriate facts and circumstances related to their respective areas (e.g., weak operating environment, regulatory deficiencies, or missing business continuity safeguards).

²³ The preparation necessary in connection with transferring funds and other related activities requires separate procedures onto itself, including setting up back accounts and files for electron fund transfers, which is outside the scope of this assessment.

²⁴ With regard to the Strategic Partnerships, there may be instances of affiliated transactions or cross-trades between two separate funds managed by the Strategic Partnership. In the event of an affiliated transaction or cross-trade, the due diligence steps would include: (i) obtaining documentation to support the transaction, including the transfer of assets between the funds; (ii) discussing the circumstances and rationale for the transaction with the relevant investment team; (iii) ascertaining the valuation (and underlying assumptions thereto) of the transaction; and (iv) obtaining a certification from the Strategic Partnership that there were no conflicts of interest in affecting the transaction.

The on-going monitoring and due diligence procedures would focus on, among other things, the following matters:

- Investment philosophy and process
- Implementation of the manager's investment strategy
- Investment performance
- Turnover in key investment professionals
- Compliance with applicable regulatory requirements
- Strategic initiatives, including changes to the organizational structure, operational processes, and technology systems

In addition, certain factors/trigger events may cause a re-evaluation of the investment manager, including termination of the manager and redemption of the investment assets. These factors and/or trigger events may include:

- Key person departures/turnover
- Normalized return analysis
- Competition for capital
- Lack of discipline in portfolio construction and risk management
- Manager style drift
- Discomfort with changes in manager personnel, degree of focus, AUM size
- Poor relative performance
- Potential for further redemptions

SAMPLE TOOLS

The following are sample tools that the Commission may use in connection with the due diligence framework. They include:

- Sample due diligence questionnaire (for distribution to External Managers currently managing assets on behalf of the Commission)
- Sample list of discussion topics
- Sample meeting agenda
- Sample document request list
- Sample compliance certification

Sample Due Diligence Questionnaire

We understand that the Commission currently utilizes asset class-specific questionnaires in connection with its initial due diligence process (collectively, the "DDQs"). The Commission should look to input the information and data collected from the DDQs into the Due Diligence Database (or document management system) to help facilitate the analysis of the responses specific to a manager, as well as information across similar managers or asset classes. In addition, a database or document management system would help the Commission analyze trends and patterns from subsequent or on-going due diligence visits (e.g., change in assets, client gains/losses, and turnover).

With regard to the on-going due diligence visits, the Commission may wish to consider amending the DDQs to focus on "changes" at the External Manager since the initial due diligence process/visit. For example, the Commission may consider changes to the following areas, activities or matters:

Organization

- The structure of the organization, including changes in ownership
- Turnover in investment and non-investment personnel
- Current or pending initiatives (e.g., new products, strategies, systems, workflows)

People

- The roles and responsibilities of the people that are responsible for the management of the Commission's account, including, but not limited to, the following areas:
 - Senior management
 - Investment management
 - Research
 - Trading
 - Operations
 - Sales and client service

Assets

- Firm-wide assets under management (AUM)
- Firm-wide AUM subject to performance fees

- Mandate specific AUM
- The Commission's account size (current market value)

Clients

- Total number of clients in mandate and the Commission's rank by size (e.g., 3 of 20)
- Total number of clients within the mandate subject to performance fees
- Client gains/losses during the period; see example below

	Total		Gained		Lost	
	Assets (\$MM)	# Accounts	Assets (\$MM)	# Accounts	Assets (\$MM)	# Accounts
3/31/20__	14,605.8	32	103.3	1.0	0.0	0.0
6/30/20__	15,290.6	36	125.5	1.0	114.5	1.0
9/30/20__	16,768.0	37	485.3	4	0	0
12/31/20__	14,061.3	30	0	0	0	0

Investment Process

- Incremental improvements made to the investment philosophy, process, or implementation
- Operational processes to support and facilitate the investment activities

Account Performance

- Performance results in connection with the previous six and 12 months
- Six- and 12-month performance versus the benchmark
- Performance since inception versus the benchmark
- Reconciliation with the custodian, including any resolution thereof
- Composite specific performance, including dispersion within the composite returns

Compliance

- Compliance with the contractual provisions and investment guidelines since the previous meeting date
- Compliance policies, procedures, or practices, including soft dollar arrangements, best execution analysis, personal securities transactions and proxy voting procedures
- Systems or procedures to monitor compliance with investment guidelines
- Counterparty risk management procedures
- Governmental, regulatory, or law enforcement, investigation, examination or other proceeding

See sample questionnaire on following page.

* * * * *



Due Diligence Questionnaire

Manager	<i>Insert Name</i>
Mandate	<i>Insert Account</i>
Meeting Date	<i>mm/dd/yyyy</i>
Previous Meeting Date	<i>mm/dd/yyyy</i>
Attendees	<i>Attach meeting agenda</i>
Prepared by	<i>Name</i>

Organization

1. Describe any changes in the structure of the organization, including changes in ownership over the past 12 to 24 months.

People

2. Describe any changes or planned changes in the roles and responsibilities of the professionals that are involved with the management of the Commission's account/portfolio. Please include any departures, additions, and other changes to the team. For departures, please state the reason; for additions, please include a brief bio. For all changes, describe each individual's roles and responsibilities, along with a discussion of the impact of these changes.
3. Provide organizational charts of the following areas:
 - a. Senior management
 - b. Portfolio management team and research group
 - c. Trading team (as applicable)
 - d. Operations group,
 - e. Sales and client service group(s)

Additionally, please provide a table listing: name; title; role; no. of years with the firm; no. of years of investment experience of the portfolio managers, research analysts, and traders that support the Commission's account/portfolio

Assets

4. Firm-wide assets under management (AUM)
 - a. Current market value
 - b. Commission market value and % of total
 - c. Change from previous meeting; reason for significant changes
5. Firm-wide AUM subject to performance fees



Clients

6. Total number of clients in mandate and Commission rank by size (e.g., 3rd of 10)
 - a. Current
 - b. As of previous meeting
 - c. Change from previous meeting; reason for significant changes
7. Significant client gains/losses, including description of clients and size of account)

Investment Process

8. Describe and explain any incremental improvements made to the investment philosophy, process, or implementation since the previous meeting date.
9. Describe any significant changes to your operational process since the previous meeting date.

Account Performance

10. Please provide the following performance information for the last 6- and 12-months:
 - a. Absolute performance
 - b. Benchmark relative performance
 - c. Performance attribution
 - d. Out-of-benchmark securities
11. Have the performance numbers been reconciled to the Commission's custodian?
12. Provide a brief overview of the account/portfolio's positioning relative to the benchmark, including relative positioning that may have a material impact on performance over the next six months

Compliance

13. Was the account in contractual and guideline compliance at all times since the last meeting date? If not, has this been documented and communicated to the Commission?
14. Have any changes to the following documents been made since the last meeting date?
 - a. Compliance manual
 - b. Code of Ethics
 - c. Investment allocation policy
 - d. Valuation policy
 - e. Soft dollar policy (if applicable)
 - f. Counterparty risk management policy
 - g. Proxy voting policy
15. What systems are used to monitor compliance with contractual provisions and investment guidelines? Have any changes to these systems been made since the last meeting date?
16. Provide an update on any governmental, regulatory, or law enforcement investigation, examination or other proceeding directly involving the firm, its owners or its employees.

Sample Due Diligence Discussion Topics

The following is a list of discussion topics, across the four assessment areas—investments, operations, compliance, and technology—that the Commission may wish to consider in connection with conducting due diligence visits. Also noted under each of the assessment areas are the individuals (or their equivalent) with whom the Commission may wish to meet with during the due diligence visits. In addition, to the extent there are discussion topics specific to a particular asset class, they are noted accordingly.²⁵

As previously noted, firm governance is an overarching area and the discussion topics are germane to the entire organization. Whether in the context of a new manager search or on-going monitoring of a current manager, these topics are the cornerstone of the investment manager's business model and investment operations and form the foundation for the discussions in the other four assessment areas.

Firm Governance

- Typical attendees:
 - Chief Executive Officer, Managing Directors and/or Principals
 - Chief Investment Officer
 - Chief Administrative Officer, Chief Operating Officer, General Counsel
- Entity structure, including affiliates and/or other entities with ownership interests (as applicable)
- Organizational structure, including key personnel, existing/future leadership, and talent management practices (i.e., key person risk, succession planning, recruiting, professional development and training)
- Compensation policy and practices, including employment contracts and non-competes (as applicable)
- Committee/sub-committee structure (e.g., Executive, Management, Policy, Investment, Trade Oversight, Counterparty and Credit, Operations, Risk and Compliance, and Technology)
- Policies and procedures, including communication, distribution, and awareness thereof
- Fee structure(s), including most favored nations clauses and side letters
- Conflicts of interest, including segregation of roles and responsibilities
- Assets under management vis-à-vis client gains/losses

²⁵ Public Markets Equity (Eqty); Public Markets Fixed Income (FI); Private Markets Hedge Funds (HF); Private Markets Private Equity (PE); Private Markets Private Debt (PD); Private Markets Real Estate (RE); Private Markets Strategic Partnerships (SP)

- Management of business relationships and third-party vendors, including services provided by legal, accounting and consulting firms, prime brokers, fund administrators, custodians, and technology consultants
- Current and future initiatives (e.g., new product launches, systems implementation, new policies, procedures and workflows, and changes in third-party relationships)

Investments

- Typical attendees:
 - Chief Investment Officer and portfolio managers, including portfolio construction team and portfolio assistants
 - Research and analysts team
 - Investor relations
 - Product engineers
 - Chief Compliance Officer
- Tenure, including industry experience, compensation policy, investment in funds (HF), back-up provisions, and turnover of the investment and trading professional
- Investment philosophy, including implementation of investment strategy/strategies (i.e., portfolio construction), compliance with IMAs and investment guidelines, and monitoring and management of style drift
- Communication of investment decisions, including relationship with other areas (e.g., operations, compliance, and technology)
- Recordkeeping, including documentation of investment decisions and allocation of investment opportunities
- Models (e.g., quantitative, discounted cash flows, internal rate of return)
- Acquisition and disposition transactions, including due diligence process, appraisal and valuation procedures, and registration of deals (RE)
- Conflicts of interest, including allocation of investment opportunities, side letters (HF, PE, SP), side pocketing (HF), and performance fees
- Risk management and oversight, including:
 - Attribution analysis
 - Risk tolerances and risk reporting
 - Portfolio holdings, portfolio risk, and concentration risk
 - Trade implementation
 - Duration risk (FI)
 - Liquidity and market risk
 - Interest rate risk

- Currency risk
- Leverage, including measuring, monitoring and managing leverage risk (HF)
- Off-balance sheet assets (HF)
- Trade execution, including timeliness, compliance with investment instructions and investment guidelines, best execution analysis, soft dollars and compliance with Section 28(e) safe harbor provisions, agency trades, principal transactions (FI, HF)
- Personal securities transactions, including front running, insider trading, and information barriers
- Proprietary accounts (HF), including side-by-side trading and trade allocations
- Derivative instruments, including compliance with ISDA Master Agreements and Credit Support Annex (see Collateral Management)
- Recordkeeping, including trade order memoranda, trade allocation decisions, trading blotter
- Collateral management, including margin requirements and capital adequacy, valuation vis-à-vis mark-to-market, liquidity, leverage, credit risk, custody, securities lending, clearing and settlement (HF)
- Counterparty risk management, including approved counterparties, counterparty exposure, credit review procedures, and credit risk models

Operations

- Typical attendees:
 - Chief Operating Officer and/or Head of Operations
 - Chief Financial Officer
 - Director of Client Services
- Organizational alignment (client, product, function), including average experience, segregation of duties, training, backup provisions, and turnover
- New account setup, including security master files, investment guidelines, rules library/engine
- Trade confirmations and settlement
- Custody and protection of client assets
- Account reconciliation processes and procedures (positions, trades, accruals, cash)
- Portfolio accounting; fees; expense allocations; net asset value calculations; pricing; material adjustments; and performance calculations
- Valuation policy and methodology, including valuation committees, challenge processes, stale prices, illiquid instruments, and pricing vendors
- Processing of corporate actions, including dividend payments
- Proxy voting, including securities lending (see also Collateral Management)
- Maintenance of books and records, including email retention, social media, privacy and security, information barriers, and destruction of records
- Fund financial statements (HF, PE)

- Internal and external reporting
- Subscription and redemption processing (HF, PE, RE), including Know Your Client, anti-money laundering, Office of Foreign Assets Control reviews

Compliance

- Typical attendees:
 - Chief Compliance Officer, including compliance officers
 - General Counsel/Chief Legal Officer
 - Chief Risk Officer
 - Director of Internal Audit
- Tenure and industry experience of the Chief Compliance Officer
- Compliance culture and "tone at the top," including access to and support from upper management
- Administration of the compliance program, including compliance resources, compliance training, compliance systems and applications (e.g., systems to monitor investment compliance), and compliance procedures, processes and controls to monitor and manage potential conflicts of interest such as:
 - Proprietary and/or side-by-side trading (HF)
 - Affiliated transactions
 - Allocation of investment opportunities, including performance fees, hurdle rates (HF) and high-water marks (HF)
 - Brokerage commissions, including soft dollar arrangements, commission sharing, and best execution
 - Most favored nations clauses
 - Side letter terms (HF, PE)
 - Side pocket arrangements (HF)
 - Valuation practices, including valuation of illiquid instruments
- Process to identify risks associated with the investment activities and operations, including risk assessments, annual compliance program assessments, forensic/transactional testing, and results related thereto
- Code of Ethics, including monitoring of personal securities transactions, restricted lists, information barriers and insider trading, gifts and entertainment, political contributions, and whistle blower program
- Oversight of investment and trading activities, including investment compliance breaches, trading errors, and style drift
- Regulatory filings (e.g., Form ADV Parts 1 and 2, Form PF, Form 13F, Schedules 13D/G, Form SLT) and disclosures, including review of advertising and marketing materials, newsletters, offering memoranda, pitch books, client communications, and internet sites
- Monitoring of electronic communications, including email retention, instant messaging, and social media

- Regulatory compliance, including results of regulatory examination(s)
- Advisory agreements, including IMAs; solicitation agreements; private placement memoranda (HF, PE, RE); and subscription agreements (HF, PE)
- Record retention, including controls to maintain and safeguard required records from unauthorized access, alteration, loss or destruction
- Oversight of sub-advisory relationships, external managers, fund-of-fund managers, service providers, and other third-party relationships

Technology

- Typical attendees:
 - Chief Technology Officer
 - Systems Administrator
 - Help-desk/support staff
 - Chief Operating Officer
- Systems architecture and systems securities measures, including firewalls and virus protection, intrusion detection, physical and logical access controls, and application security
- Production and development environments, including change management protocols
- Contingency planning, including data protection, scenario analysis, business continuity plans (BCP), disaster recovery, secondary sites, BCP testing, and third-party vendor management
- Systems initiatives

Based on the circumstances/needs, the above discussion topics may be covered in their entirety or in part as a targeted site visit that focuses on a particular area such as investment compliance or back-office operations. For targeted visits, the length and discussion topics may be adjusted accordingly. The following is a sample one-day meeting agenda.



Investment Adviser

Date | City, USA

MEETING AGENDA

9:00 am – 10:30 am

Possible Attendees:
Managing Partner
Chief Executive Officer
Chief Operating Officer

Introductions

Board Oversight and Governance Structure

- Reporting and communications with the fund Board(s)
- Interaction with the Chief Compliance Officer (“CCO”) and the compliance staff
- Oversight of portfolio management activities, including limitation on self-dealings

10:30 am – 12:00 pm

Possible Attendees:
Chief Investment Officer
Portfolio Manager(s)
Reach/Analyst Team

Investment Management Activities and Advisory Relationships

- Portfolio management team, including turnover and succession planning
- Investment process, execution and oversight, including investment compliance
- Conflicts of interest management (e.g., side-by-side trading)
- Relationship between portfolio management and the other functional areas involved in the investment process

12:00 pm – 1:00 pm

Break

1:00 pm – 2:00 pm

Possible Attendees:
Head Trader(s)
Portfolio Manager(s)
Chief Operating Officer

Trading and Brokerage Operations

- Trade execution, aggregation and allocations, including counterparty selection and affiliated transactions
- Trade Error Management
- Best execution analysis and soft dollars
- Trade Order Management Systems

2:00 pm – 3:00 pm

Possible Attendees:
Chief Compliance Officer
General Counsel
Chief Risk Officer

Compliance

- Administration of compliance policies and procedures, including Code of Ethics, personal trading, annual CCO assessments, and interactions with the Board(s)
- Compliance oversight of investment and trading activities, including investment compliance and trading errors
- Approved counterparties and affiliated transactions
- Regulatory compliance, including results of regulatory examinations

Investment Adviser

MEETING AGENDA (CONT.)

3:00 pm – 4:00 pm

Possible Attendees:

Chief Operating Officer
Chief Financial Officer
Director of Client Services
Chief Technology Officer

Operations and Technology

- New account set-up
- Trade confirmations and trade settlements
- Account reconciliation process
- Valuation, pricing, and performance oversight
- Corporate actions
- Proxy voting
- Reporting: internal and external communications
- Maintenance of books and records
- Technology administration, including technology infrastructure and systems security
- Business continuity and disaster recovery, including business continuity testing, alternate locations, and business continuity testing results
- Walk-through of operational processes

4:00 pm – 4:15 pm

Break

4:15 pm – 4:30 pm

Possible Attendees:

Open to anyone wishing to attend

Wrap-up

Day-2 agenda (if necessary, may complete walk-through of operational processes on day-2)

Sample Document Request List

The following is a list of documents and/or information the Commission may request in connection with its initial or on-going due diligence site visits:

Organizational Information

- Organizational chart, including CVs of key investment professionals
- Fund structure chart (as applicable), including the following information related to each of the funds
 - Launch date
 - Committed and invested capital
 - Commitment and/or investment period
 - Investor fee structure
 - Target liquidation date
- Most recent Form ADV filed with the U.S. Securities and Exchange Commission (SEC) or other equivalent disclosure documents
- Sample client advisory contracts, sub-advisory agreements, subscription agreements, offering memoranda, limited partnership agreement, solicitation agreements (as applicable)
- Current prospectuses and Statements of Addition Information (as applicable)
- Sample due diligence questionnaire (as applicable)
- Sample pitch book, investor presentation or other marketing materials to solicit clients (as applicable)
- Assets under management by client type and product type, including client gains/losses for the past three years and number of clients by product type
- Turnover of investment and non-investment professionals for the past three years
- Pending litigation or regulatory actions
- Audited fund financial statements (as applicable)

Investment Management, Trading and Brokerage Operations

- Minutes from investment and/or portfolio committee meetings (if available), including presentation materials
- Holdings report for all client portfolios as of [INSERT DATE], including top 10 holdings
- Trade blotter listing transactions in securities and financial instruments [PROVIDE DATE RANGE/PERIOD]
- Brokerage commission report, including documents/reports created to evaluate best execution obligations

- Soft dollar budget and/or commission sharing arrangements, including a schedule of each soft dollar arrangement that includes the name and description of the product or service received, the broker-dealer to whom soft dollar trades are directed, and the party who utilizes the product or service
- List of approved counterparties and affiliated broker-dealers (including a description of the affiliation and clearing arrangements)
- Trading policy, including trade error and trade allocation policies

Operations and Technology Administration

- Valuation policy, including list of pricing and quotation services
- List of fair-valued and/or illiquid securities held in client portfolios
- Supporting documentation for advisory fee calculations, including performance fees (if applicable)
- Standard Operating Procedures ("SOPs") as they relate to back-office operations including account reconciliations, pricing, fair valuation, expense allocations, proxy voting and corporate actions
- Procedures for safeguarding client records, including physical and logical access controls
- Business Continuity Plan ("BCP"), including the date, results and any remedial action resulting from the last test of the BCP
- The schedule of BCP testing activity
- Information Technology ("IT") procedures including those relating to IT change management and IT security

Legal and Compliance

- Compliance policies and procedures, including Code of Ethics and record of actions taken as a result of violations of the Code of Ethics
- Map/inventory of identified compliance risks, including results of risk assessment(s)
- Results of the Chief Compliance Officer's annual compliance program assessment, including results from any forensic/transactional testing
- Internal audit report (if available)
- Log of investment compliance breaches and/or trade errors
- Log of personal securities transactions, including list of pre-clearance requests denied and the reasons for denying the request
- Anti-money laundering policies and procedures, including procedures to comply with Office of Foreign Assets Control, Bank Secrecy Act, and Internal Revenue Code (money instrument reporting provisions) requirements
- Correspondence with the SEC and with other regulators, including deficiency letters and responses thereto [PROVIDE DATE RANGE/PERIOD]

Sample Compliance Certification

As part of the on-going due diligence process, the Commission may wish to request a "certification of compliance" from its external managers. Certification items may include, but are not limited to, the following:

- Changes in key personnel, including equity owners, senior management, and/or investment professionals
- Changes in assets under management (AUM), including drivers precipitating the change in AUM (e.g., client gains/losses, capital contributions, distribution, rebalancing, market movement)
- Changes in business and/or investment model (e.g., new products, workflows, processes, systems)
- Compliance breaches such as investment guideline violations, trade errors, or Code of Ethics violations
- Findings in connection with regulatory examinations and/or compliance audits

The following is a sample Certification of Compliance for the Commission's consideration.

* * * * *

Sample Compliance Certification

EXTERNAL MANAGER LETTERHEAD

Certification of Compliance

[INSERT DATE]

Re: Disclosure Compliance Certification Statement

Dear [INSERT NAME],

By signing below, I certify on behalf of [INSERT COMPANY] (the "Company") that, during the period [INSERT DATE] through [INSERT DATE], there have been

- No changes in key personnel, including equity owners, senior management, and/or investment professionals
- No changes in the Company's business and/or investment model (e.g., new products, workflows, processes, systems)
- No material¹ changes in assets under management
- No compliance breaches related to investment guideline violations, trade errors, or Code of Ethics violations
- No outstanding findings in connection with regulatory examinations and/or compliance audits

Signature of Officer

Printed Name of Officer

Title of Officer

¹ Please define materiality threshold: _____.

III. Valuation of Alternative Investments

SAMPLE VALUATION GUIDELINES

Overview

Management (i.e., the Commission) is responsible for making the valuation measurements and disclosures included in the financial statements. As part of fulfilling this responsibility, management should establish accounting and financial reporting processes for determining valuations, supporting any significant assumptions used in connection with the measurements, preparing the valuation (as appropriate), and ensuring that the presentation and disclosure of the valuation measurements are in accordance with applicable generally accepted accounting principles. To the extent that management intends to delegate some or all investment management responsibilities to external investment managers, management should have controls in place to assess and monitor the valuation practices of those external managers on a pre- and post-investment basis.

Initial Due Diligence

Pre-investment procedures may include the following:

- Holding face-to-face meetings with the prospective investment managers to gain an understanding of the managers' valuation policy, methodologies, and practices, including any governance committees to oversee the valuation process
- Evaluating the manager's investment philosophy, processes related to portfolio construction and implementation of the investment strategy, and historical track record
- Requesting documentation such as offering documents, LPAs, IMAs, financial statements, Form ADV (as applicable) and other related investor communications (e.g., pitch books, request for proposals, information requests, and due diligence questionnaires)
- Evaluating how the allocations fits within a particular asset class or portfolio
- Reviewing and negotiating legal agreements
- Preparing a formal investment memo or write-up for approval

On-going Monitoring

Post-investment procedures may include the following:

- Conducting regular and periodic communications—in-person or telephonically—with the investment manager to obtain an understanding of the manager's investment strategies and holdings²⁶
- Obtaining the fund's audited financial statements and noting (a) whether the independent auditor's opinion is unqualified on a GAAP basis or modified; (b) change in audit firm; (c) change in valuation procedures; (d) subsequent events footnote, if any; and (e) other disclosures that may impact the valuation or management's disclosures
- Reviewing internal controls reports (e.g., SSAE No. 16 or equivalent)
- Requesting the details of the portfolio to ascertain the nature of the underlying investments (e.g., marketable securities, derivatives, private companies, or real estate) to support management's conclusions with regard to the reasonableness of the valuations²⁷
- Reviewing portfolio valuations for reasonableness and reconciling with the custodian's pricing
- Requesting and reviewing any changes to the valuation procedures
- Reconciling the investment manager's year-end valuations to the audited financial statements (to the extent there are significant discrepancies or variations, the Commission will follow-up the SCRS and/or the External Manager)
- Comparing the value at the fund's year-end to the value at management's year-end and assess reasonableness of the change considering any adjustments, appreciation/depreciation, additions, distributions, and other changes
- Monitoring and comparing portfolio performance to the following:
 - Benchmark and expected returns
 - Publicly available data
 - Cash returns to previously reported market values
- Evaluating mid-stream changes to the investment strategy, including any impact to investment performance²⁸
- Reviewing press reports for significant changes to senior management, staffing levels, and AUM (increases or decreases)

²⁶ To the extent the Commission is able to obtain a seat on the board of a portfolio company or participate as a voting member of a valuation committee, the Commission should actively participate and engage in the External Manager's valuation processes related thereto.

²⁷ For hedge funds and other private funds, the Commission should compare, for reasonableness, estimated values from the funds to the final values from the fund administrator.

²⁸ Should the manager's investment strategy change from the original investment approach, the Commission should conduct an in-depth assessment of the manager, including back-testing all material Level 2 and 3 investments by comparing the investments' transaction price in the subsequent period against the fair value of those investments reported in the most recent reporting period.