



**pennsylvania**

STATE EMPLOYEES' RETIREMENT SYSTEM

**Commonwealth of Pennsylvania**  
**State Employees' Retirement Board**

**Investment Manager Monitoring Policy**

**Adopted October 29, 2014**

**Amended December 7, 2016**

SERS employs external investment managers to manage pension fund assets. SERS' Statement of Investment Policy charges the Investment Office with responsibility for coordinating all investment activities and matters for SERS, including the continual review and analysis of investment managers. It also allows for the use of external investment consultants to provide various investment-related services, including assistance with the analysis of investment managers.

SERS Investment Office, in consultation with its external general investment consultant and external real estate investment consultant, developed this Investment Manager Monitoring Policy ("Policy"). The purpose of this Policy is to provide the SERS Board with an enhanced communication tool to keep the Board informed of investment managers that warrant additional monitoring by SERS Investment Office and external consultants.

An Investment Manager Evaluation List (Appendix 1) was developed to clearly communicate which investment managers have been identified as experiencing quantitative or qualitative pattern changes worthy of greater review by SERS Investment Office and external investment consultants. Although a quantitative analysis is clearly important, it is not a best practice to rely exclusively on such data when evaluating investment managers due to the imperfect nature of many indices used as portfolio benchmarks. In addition, the placement of an investment manager on the Investment Manager Evaluation List does not automatically serve as evidence of a problem with the investment manager. This can only be determined after SERS Investment Office and external investment consultants enhance its ongoing monitoring.

#### **A. Investment Manager Monitoring Guidelines and Evaluation List**

The Investment Manager Monitoring Guidelines formalize the identification and application of qualitative and quantitative criteria employed by SERS with respect to the monitoring of current investment managers in the following asset classes of the SERS investment program.

- Global Public Equity
- Public REITs
- Hedge Funds
- Fixed Income
- Cash

The Investment Manager Monitoring Guidelines:

- 1) establish clear expectations between the SERS Board, Investment Office, external investment consultants, and investment managers,
- 2) enhance communication among the SERS Board, Investment Office, external investment consultants,
- 3) encourage the use of prudently applied criteria to evaluate investment managers,
- 4) foster a long-term approach toward performance evaluation of investment managers,
- 5) focus the resources of SERS Investment Office and external investment consultants on those investment managers most likely to require additional attention,

- 6) avoid costly turnover in investment management relationships driven by a period of short-term poor performance, and
- 7) improve the probability that SERS will identify problematic relationships which otherwise might produce unsatisfactory investment returns.

In general, the Investment Manager Monitoring Guidelines apply to investment managers with assets that are valued at least monthly. Investment managers that are in liquidation are excluded from the Investment Manager Monitoring Guidelines.

The SERS Board endeavors not to make adverse retention decisions about investment managers based upon performance absent at least three years of performance data, recognizing that investment strategies are best assessed over full market cycles. All of the criteria identified in the Investment Manager Monitoring Guidelines are intended to provide a normal, minimum standard for retaining investment managers.

However, the SERS Board may terminate any current investment manager for any reason whatsoever in accordance with the provisions of investment management agreements between SERS and the external investment managers. These Investment Manager Monitoring Guidelines do not limit SERS ability to take such action.

## **B. Criteria for Active and Passive Management**

### Addition to the Investment Manager Evaluation List

SERS Investment Office, in consultation with its external investment consultant, will place an investment manager on the Investment Manager Evaluation List for any of the following reasons:

#### Quantitative Factors

1. The active investment manager's rolling, three-year return falls below the rolling, three-year benchmark return for four (4) consecutive quarters. This is a net of fee comparison.
2. The active investment manager's rolling, three-year return ranks below the median of the external investment consultant's peer group for four (4) consecutive quarters (excludes investment managers with no relative peer group). This is a gross of fee comparison.
3. The passive investment manager's rolling three-year return is not in line with the rolling, three-year benchmark return. SERS Investment Office and the external investment consultant will determine what variance from the benchmark is deemed acceptable, given the passive strategy. This is a net of fee comparison.
4. The active or passive investment manager's return significantly deviates from its expected return established in its investment strategy statements (investment guidelines) with SERS. This is a net of fee comparison.

## Qualitative Factors

1. A significant and potentially adverse event related, but not limited, to any of the following qualitative issues or events, will be considered:
  - Violation of investment guidelines
  - Deviation from stated investment style and/ or shifts in the firm's philosophy or process
  - Turnover of one or more key personnel
  - Change in firm ownership or structure
  - Significant loss of clients and/or assets under management
  - Significant and persistent lack of responsiveness to client requests
  - Litigation
  - Failure to disclose significant information, including potential conflicts of interest
  - Chronic violations of the SERS' Statement of Investment Policy
  - Any other issue or situation of which SERS Investment Office, external investment consultants, and/or SERS Board members become aware that is deemed material.

### Removal from the Investment Manager Evaluation List

An investment manager may be removed from the Investment Manager Evaluation List when SERS' Investment Office and the external investment consultant agree that the investment manager has satisfactorily met the quantitative or qualitative criteria for removal from the Evaluation List. Generally for active investment managers, two consecutive quarters of rolling, three-year performance above the benchmark and a ranking above the median of the external investment consultant's peer group following placement on the Evaluation List will be required for an investment manager's removal from the Evaluation List for performance reasons. For index fund investment managers, one period of rolling, three-year performance in line with the benchmark following placement on the Evaluation List will be required for an investment manager's removal from the Evaluation List for performance reasons. SERS Investment Office and the external investment consultant will typically make a decision to recommend retention or termination twelve (12) months following placing an investment manager on the Evaluation List. At the point of decision, SERS Investment Office and the external investment consultant may recommend renewing inclusion on the Evaluation List for an additional period of time subject to supporting due diligence.

### **C. Application of Criteria**

1. The Investment Manager Evaluation List is a confidential internal document and will only be used for internal purposes.
2. SERS Investment Office, in consultation with external investment consultants, will provide the SERS Board with a current Investment Manager Evaluation List at the same board meeting when the general investment consultant's quarterly performance is provided to the SERS Board. The Evaluation List will include all investment managers which have been added or removed and summary of the reasons for the addition or removal.

3. The Investment Manager Evaluation List will be provided to the SERS Board in executive session.
4. When an investment manager is placed on the Investment Manager Evaluation List, SERS Investment Office and external investment consultants will enhance its ongoing monitoring of the investment manager to assess whether or not genuine issues of concern actually exist.
5. If genuine issues of concern are identified, SERS Investment Office and external investment consultants will assess the cause, magnitude, and likely duration of the issues.
6. If the analysis from SERS Investment Office and external investment consultants reveal that the issues are not of concern, the investment manager will be removed from the Investment Manager Evaluation List.
7. If the investment manager resolves the issues of concern to the satisfaction of SERS Investment Office and external investment consultants, the investment manager will be removed from the Investment Manager Evaluation List.
8. If SERS Investment Office and external investment consultant determine that the issues of concern have persisted without satisfactory resolution or are unlikely to be resolved within 12 months, then a recommendation on whether to retain the investment manager will be provided to the SERS' Board.
9. In emergency situations, the Chief Investment Officer, in consultation with the Chairman of the SERS Board, may make investment decisions (i.e., halt trading or terminate an investment manager). Emergency situations are defined as those that are unforeseeable and in the absence of action, the Fund may be adversely impacted. In the event such action is taken, the SERS Board will be notified as soon as practical, but no later than the next scheduled board meeting. This is defined in SERS' Statement of Investment Policy.

## Appendix 1: Investment Manager Evaluation List (TEMPLATE)



### Memorandum

To SERS Board Members  
 From SERS Investment Office and RVK  
 Subject Investment Manager Evaluation List  
 Date <insert date>

The following is the Investment Manager Evaluation List (“Evaluation List”) as of <insert quarter-end date>. The Evaluation List is compiled in conformance with the criteria established in the Investment Manager Monitoring Policy adopted by the Board on October 29, 2014.

The placement of an investment manager on the Evaluation List does not automatically serve as evidence of a problem with the investment manager. The Evaluation List was developed to clearly communicate which investment managers have been identified as experiencing quantitative or qualitative pattern changes worthy of greater review by SERS Investment Office and external investment consultants.

### Summary

Manager	Asset Class	Strategy	Assets	Event Date
<b>1. Additions Since Last Report</b>				
<b>2. On Evaluation List</b>				
<b>3. Deletions Since Last Report</b>				

### Evaluation List

Manager	Reason	SERS Investment Office & RVK Recommendation