

Enhanced Due Diligence and Ongoing Management Process for Infrastructure and Private Equity Investments

Enhanced Due Diligence (EDD) Team: Responsible Investment (RI) & Operational Due Diligence (ODD)

Objective: *To assess the risk of financial loss and reputational risk arising from extra-financial factors of an asset and the key individuals associated with that asset. Extra-financial factors will include environmental, social and governance factors as well as criminal and unethical corporate and personal behaviour; and to ensure for fund investments that the external managers incorporate these issues into their due diligence and asset management processes.*

1. **Overview:** The Enhanced Due Diligence (EDD) process will seek to identify any criminal, ethical, governance, reputational, environmental and social risks, which could potentially affect the value of infrastructure and private equity, direct and co-investment transactions, pre and post investment. It will also assess whether USS' external managers have appropriate processes to mitigate these factors. The EDD will also seek to highlight wider reputational issues to USS through its ownership of the asset.

An initial report detailing the key areas of interest and risk, potential measures that could be undertaken to mitigate concern, and the process undertaken (e.g. sources used) will be drafted to an agreed format. The scope of the report should be agreed between the EDD team and Deal team. If there is any disagreement over the scope, it will be resolved by the Head of Private Markets Group (PMG). The initial report should be sent to the Head of PMG and the Deal Team for discussion at the Approval Committee (AC) and updated post-discussion, highlighting any issues which were unresolved. A risk rating (low/medium/high) will be provided to indicate the severity of any on-going concerns.

A copy of the final report will be sent to the Chief Compliance Officer prior to the Private Markets Investment Committee decision.

The report will be broadly divided into two sections; the investigative searches on key individuals and co-investors, and the wider ESG and reputational issues. The former will be the responsibility of the ODD team and the latter, the RI team.

For existing USS' external managers, ODD and the RI team may have previously assessed that manager's process and as such a new assessment may not be necessary. The relevant teams will be responsible for such decisions although the Head of PMG can ask that an assessment takes place if they believe it is necessary.

Due to the nature of this form of DD, the searches cannot be guaranteed as exhaustive. The DD will be tailored to the investment under consideration to reflect inter alia the constraints of the data, time available, the size of the investment and USSIM's influence.

2. **Process:** The EDD process will usually commence following the publication of the Deal Qualifying Memorandum (DQM) at a kick-off meeting to which a representative of the EDD team will be invited. The process could commence at an earlier stage, or later, if deemed appropriate by the Deal Team in consultation with the RI Team. The EDD Team will need to understand the investment thesis and have access to relevant documentation and deal team in order to ensure the relevance of the EDD.

The principal source of Information for the EDD will be provided by the Deal Team, and researched from a range of other sources. An RI questionnaire will be sent to potential private equity GP's, and a follow up call with usually by undertaken to assess further the manager's processes.

If deemed appropriate by the AC, and dependent on access and timings, etc, further telephone or face-to-face meetings may be undertaken by the EDD team with the relevant individuals of the company/ asset/ consultancy firm.

The issues highlighted in the EDD report will be assessed by the deal team and, if appropriate, may lead to additional due diligence undertaken by the deal team. The EDD report will be shared with the AC throughout the due diligence process to provide assurance to the AC that all issues have been resolved. The final EDD report will be included in the Private Markets Investment Committee (PMIC) Memo and the EDD team will be invited to participate in the PMIC to answer specific questions.

3. Coverage: The enhanced DD is likely to consider the following areas:

3.1. Governance

- a) Investigative searches on key individuals (as identified in discussion with the Deal Team). EDD team will flag to the Deal Team any matters which could raise questions regarding the individual's probity, decision making, conflicts of interest or that could affect USS's reputation. Key individuals would ordinarily include the directors of the target entity and the vendor entity as well as key individuals of the external manager if it is a fund investment. Investigative searches will include adverse media searches, watchlists and Politically Exposed Persons (PEP's) utilising Lexis Nexis and other information sources.
- b) Investigative searches on the key assets involved. Where information is available (and where deemed relevant), the EDD Team will seek to review company Report and Accounts or other regulatory filings to gain insights into the quality of governance of the asset(s) under consideration. Areas of interest include independent oversight, governance structures, directors' service contracts, remuneration disclosures, auditor reports, company by-laws and voting rights.
- c) Investigative searches on co-investors may also be undertaken where their identity is disclosed and is deemed necessary due to the nature of the co-investors to ensure that potential reputational risks are identified and understood.

3.2. Environmental and social factors

The EDD will consider and make recommendations for risk mitigation in the following areas (where appropriate).

- a) The asset's exposure to environmental or social risks e.g. energy use, water use, greenhouse gas emissions, human capital management, health and safety issues, waste and production efficiencies.
- b) Risk management – the DD will take a view on whether the risks identified are adequately managed and whether there is effective oversight at senior management and board level.

These issues would ordinarily be addressed by external due diligence providers engaged by USS and / or other participants in the particular deal for direct assets and the reports produced by these advisers will be the key source documents for the EDD.

3.3. USS Reputational Issues

The EDD will look to identify any wider issues for USS in owning the asset or external manager such as exposure to countries subject to financial sanctions or unethical corporate behaviour.

4. **Information Sources:** The following sources, amongst others, may be used. Lexis Nexis, Annual Reports, environmental and CSR reports, Deal Docs, directors' bio's from target asset, Boardex, FSA and other regulatory body checks, GMI, Reprisk, and, if appropriate, interviews with directors and/or senior management and relevant regulatory bodies. Source materials will be saved on SharePoint by the EDD team and identified in the EDD report for each deal. The data used will vary between deals.
5. **Outline of EDD Report:** An initial EDD report will be prepared for discussion with the Deal Team and a copy sent to the Head of PMG. The report will provide an overview of potential ESG risks identified, with possible mitigating factors. The report will cite the documents, source materials and individuals consulted internally and externally in an Appendix. The report will be updated following discussions with the Deal Team (and any further investigations).

A copy of the final report will be sent to the Chief Compliance Officer prior to the PMIC.

The EDD process will conclude with power point slide(s) for the PMIC highlighting the key risks, and assigning a rating to reflect the severity of the on-going concern(s).

6. Ongoing management of investments

Given the nature of these assets, it is essential that the fund continues to monitor and manage extra financial factors over the life of the investment. For direct investments, these considerations will be part of the separate Asset Management Plan for the asset. For example consideration could be given to:

- i. Background checks of key appointments.
- ii. Incentive arrangements for key personnel
- iii. Periodic reviews of the management of environmental and social issues to ensure business efficiency and appropriate risk management.

For fund investments, the RI team will update their assessments with on-site visits with the external managers as deemed necessary.

Version 4.0 March 2014