NEW MEXICO EDUCATIONAL RETIREMENT BOARD

Private Equity Investment Policy

New Mexico Educational Retirement Board ("ERB") hereby adopts the following Private Equity Investment Policy.

POLICY

I. Introduction

The New Mexico Educational Retirement Board (the "ERB") has authorized an allocation of a portion of its investment portfolio to the Private Equity ("PE") asset class as defined in this policy. This PE Policy Statement sets forth the objectives, investment guidelines, and investment process governing the ERB PE investment portfolio. This PE policy supersedes any prior version of the policy and is subordinate to the NMERB Investment Policy Statement and Placement Agent Policy and Campaign Contribution Policy. In addition, it describes the roles and responsibilities of the ERB, the ERB Investment Committee (the "IC"), the ERB's investment staff (the "Staff"), and the ERB's external PE consultant (the "Consultant") relating to the oversight and management of the Private Equity Portfolio.

II. Strategic Objectives

ERB believes the risk adjusted returns and diversification of the ERB investment portfolio can be enhanced by investing a portion of the total portfolio in the PE asset class. The strategic objective for the PE asset class is to:

A. Enhance the return of the total portfolio through investment in a portfolio of PE strategies targeting attractive risk adjusted returns.
B. Allow ERB to invest in strategies and opportunities that are not available through publicly traded investments.
C. Enhance the return and diversification of ERB's exposure to the equity asset class.
D. Actively invest resources to identify strategies and managers within those strategies that provide the opportunity for above average risk adjusted results.

III. Allocation to the Private Equity Asset Class

ERB has approved a target PE allocation as detailed in the NMERB Investment Policy Statement. ERB recognizes it can take many years to build a PE portfolio and so an interim target to PE has been established to better reflect the progress to date of building the target allocation. The use of an interim target will allow for better calculation of the policy index performance while the PE allocation is building toward the target allocation. It is anticipated that the interim target will increase steadily over time as the PE allocation reaches its long term target.

IV. Investment Alternatives

The ERB PE portfolio will be diversified among a variety of funds pursuing various investment strategies to reduce the risk of the PE portfolio. Investment strategies shall generally fall within the categories defined below:

A. **Buyout and Corporate Restructuring Capital:** Includes investments in leveraged buyouts, management buyouts, equity buyouts, employee buyouts, buy-and-build strategies, corporate carve-outs, and other acquisition strategies and restructurings related strategies.
B. **Venture Capital:** Venture Capital ("VC") investments are young businesses with large potential. Often these types of investments are supporting technologies or business models which are disruptive and have the potential for significant growth. VC investors may be actively involved in their companies. In general, the individual VC portfolio companies are higher risk and higher return than buyout investments, however, the risks of VC investments is reduced when done within a diversified venture capital portfolio.
C. **Growth Equity:** Growth Equity ("GE") is defined as investment in established companies to accelerate growth. These investments are often minority equity interests with protective governance provisions or structured investments with both debt and equity characteristics. In general, GE portfolio companies are not highly leveraged and invest profits in growth. These companies can benefit significantly from operational support to manage their growth.
D. **Mezzanine Financing:** The goal of mezzanine strategies is to generate current income for the investor with an opportunity for capital appreciation through the exercise of warrants/equity positions. Under this broad classification ERB includes corporate mezzanine strategies, royalty strategies, project finance and venture lending.

    1. ***Corporate Finance*** includes mezzanine investments in sponsored and non-sponsored transactions or financings. The sponsored transactions will be made at the time of a buyout transaction and involve underwriting of the company and the buyout strategy.

    2. ***Royalty Strategies*** including Healthcare Royalties, Intellectual Property Royalties or other Royalty Strategies which may invest in royalty streams of healthcare products, intellectual property assets, or other cash-flowing royalty streams.

    3. ***Project Finance*** involves providing financing to specialized energy or infrastructure projects and are often structured investments with both debt and equity characteristics.

    4. ***Venture Lending*** strategies have mezzanine characteristics and are generally a structured investment including senior debt with attached equity warrants in venture capital backed companies.

E. **Energy:** Energy investments are typically growth equity and debt or equity project financing investments in companies developing oil, gas and mineral resources throughout the energy and resource supply chain.

F. **Special Situations** may include:

1. ***Distressed Securities***: Distressed strategies can be either debt or equity securities investments in underperforming companies. The strategy may be control oriented, seeking to take control of the companies by purchasing a controlling interest in the debt or equity securities. Non control strategies seek to purchase undervalued securities across the capital structure, and benefit from a potential restructuring under the assumption that the securities will appreciate in value following a restructuring of the company's obligations. Under both control and non-control strategies, investors may benefit from Bankruptcy Court restructuring.

2. ***Other investments as deemed appropriate****:* Other investments may be opportunistic in nature and must be consistent with the risk and return goals of the PE program.

G. **Secondary Funds:** Secondary investments may include the acquisition of partnership interests in existing PE funds, direct secondary interests in PE backed companies, structured secondary transactions which may purchase an interest in a portfolio of PE funds, or the recapitalizations of existing PE funds. Secondary Fund managers often benefit from buying at a discount from a seller requiring liquidity.

H. **Co-Investment Strategies:** Investments in Funds or Separate Account vehicles with General Partners specializing in sourcing and evaluating co-investments. This strategy may include investment in overflow vehicles of underwritten funds that allows the General Partner to close on transactions that require more capital than the lead funds can invest.

I. **Separate Accounts**: Investment vehicles investing in any of the strategies enumerated above in a vehicle dedicated to ERB that provide significant benefits to ERB over similar fund vehicles in terms of fees and/or investor rights.

V. Benchmarks

The PE portfolio is expected to enhance the equity returns of the total Plan and generate returns, net of all fees, expenses and carried interest in excess of the Russell 3000 index plus 3%. The benchmarking vs. the Russell 3000 or other broad market indices will be done using Public Market Equivalents ('PMEs") of the indices which will be calculated to mirror the cash flows of the program. The ERB understands that, for a given partnership, returns can only be reliably measured over the life of the partnership (typically approximately 8-10+ years) and so the ultimate performance of the PE portfolio is difficult to judge for recent vintage years where the strategies have not yet seen significant realizations. In addition, the internal rate of return performance in the first few years of a partnership's life is anticipated to be negative for many strategies due to the J-curve effect. Partnership investments during the J-curve period may have a capital account balance lower than the invested capital due to management fees, partnership expenses and the lack of maturity in portfolio companies due to the fact that management has not yet fully incorporated growth initiatives.

Early in the life of the private equity portfolio, performance will be assessed relative to peer group data. This data will measure vintage year performance to determine that individual funds are performing in line with peer funds from a similar vintage. Public Market Equivalent indices will also be used for intermediate and long term benchmark comparisons to public markets in order to eliminate any difference between dollar weighted and time weighted returns when comparing to public benchmarks.

VI. Risk Management

ERB understands that PE fund investments are illiquid and will have a long holding period. When used with publicly traded assets, the PE asset class helps provide a diversified source of enhanced return and reduces risk at the total fund level. Nonetheless, ERB expects that the Staff and Consultant will take all appropriate measures to reduce risks that are not adequately compensated for by expected return.

A. **Risk and Return Assessment** As with other types of investments, PE investment includes the risk of loss of capital on any individual investment, which can be partially mitigated by the diversification of investments. Key risk considerations for PE include:

1. ***Market Risks*** **-** Market risk, includes changes in the overall economy, and decrease in purchase multiples for PE investments or changes in the supply and demand for private companies.

2. ***Illiquidity Risk*** - By its nature, PE investments are not designed to meet any short-term liquidity needs. ERB should assume that the investments in this asset class are illiquid until the partnerships, at their discretion, sell investments and distribute proceeds.

3. ***Leverage*** **-** Many PE investments utilize leverage in order to enhance returns. This leverage may cause increased volatility in reported and realized returns and increases the risk of loss of capital in the event cash flow from the business is insufficient to service debt.

4. ***Manager Risk*** - The success of PE investments is highly dependent on manager skills, organizational effectiveness and stability, and retention of key persons. Manager risks can often be mitigated through governance provisions in partnership documents.

5. ***Vintage Year Risks*** **-** While it is possible to identify which economic environments may benefit an investment strategy, the investment period of a fund can last between two and six years. Therefore, the market environment can be expected to change during this period. A portfolio approach to asset allocation should be taken to avoid over emphasizing the current market environment.

6. ***Fundraising Risks*** **-** Often investors are hesitant to close on a fund until a sufficient amount of capital is raised to allow the firm to effectively pursue their stated strategy.

7. ***Investment Strategy Concentration Risk*** – The PE portfolio will be diversified by market segment, strategy, industry sector and style.

B. Diversification and Risk Management Guidelines

The PE portfolio shall be diversified as to investment strategy, timing of investment, size and life cycle of investment, industry sector, investment sponsor organization (e.g., general partner group), capital structure and geographical location. Fund commitment sizes are limited to 10% of target total PE portfolio size, while separate accounts may be up to an asset value of 15% of the total ERB PE allocation. The following is the sub-asset class investment diversification limitations.

Sub-Asset Class Allocations Ranges			Allocations by Geography	
Buyouts	0% - 80%		North America	50% - 100%
Venture	0% - 40%		Europe	0% - 50%
Growth	0% - 40%		Other	0% - 20%
Mezzanine	0% - 40%			
Energy	0% - 30%			
Special Situations	0% - 40%			
Secondary Funds	0% - 40%			
Co-Investments*	0% - 50%			
Separate Accounts*	0% - 40%			
*Separate Account and Co-Investment allocations are account structures and so the assets contained within these structures will be attributed to the appropriate strategy allocations.				

VII. Strategic Planning Process

A strategic plan (Plan) will be drafted annually that includes a pacing analysis, and a detailed review of the current portfolio and market environment necessary to formulate a recommended commitment plan for the coming four to eight quarters. The Plan will include the following:

A. **Target Allocation and Pacing.** The allocation to PE will be targeted at the market value and shall be established under ERB's periodic asset allocation review. Staff and the Consultant will develop an annual pacing plan in order to implement the target allocation. In cases where ERB is over target, it is preferred to maintain vintage year diversification through smaller commitments rather than increase vintage year risk by taking a commitment holiday.

B. **Targeted Strategies for Commitment.** The strategic planning process will generate a schedule of planned commitments by strategy based on the current portfolio strategy allocations and the market outlook for various PE strategies. The strategic planning process will provide a roadmap for commitments over the next four to eight quarters. The precise timing of commitments by strategy may vary somewhat to the plan based on the timing of the search processes, and the fundraising schedule of targeted funds.

C. **Investment Criteria.** ERB is a market rate program that is open to all PE funds and other vehicles that meet policy requirements. Specifically, each PE investment vehicle wishing to qualify must be a limited partnership, limited liability company, Société à responsabilité limitée (S.A.R.L.) or corporation that:

1. Is an appropriate investment opportunity with the potential for risk adjusted returns superior to traditional investment opportunities and not otherwise prohibited by the ERB. Investments shall generally fall within the targeted categories;

2. Holds out the prospects for capital appreciation from such investments comparable to similar investments made by other professionally managed PE funds;

3. Accepts investments only from accredited investors, as that term is defined in Section 2 of the Federal Securities Act of 1933, as amended (15 U.S.C. Section 77(b)) and rules and regulations promulgated pursuant to that section; and

4. Has full-time management with at least five years of relevant PE experience.

VIII. Investment Methodology

A. **PE Portfolio Investment and Review**. The Staff, under the direction of the IC and with the assistance of the Consultant, shall make investment allocations and monitor the performance of the PE Portfolio consistent with the Policy Statements.

B. **Accounting and Reporting**. The Staff, with the assistance of the Consultant, shall use a portfolio accounting and reporting system that: (1) accurately reports portfolio and investment returns consistent with industry accounting and reporting standards, and (2) describes and assesses portfolio risk/return attributes on a timely basis. Also, the Staff, with the assistance of the Consultant, shall develop a system that reconciles quarterly ERB internal and/or external records with the Consultant-monitored investment manager reports, including with respect to account balances and returns, to ensure that any variances are reconciled on a timely basis.

C. **Contract Execution**. After legal review of all appropriate documents the following will have contract execution authority for said documents: Chief Investment Officer, Executive Director and Deputy Executive Director.

D. **Administrative Process**. Staff shall establish processes to:

1. Monitor and document the progress and performance of each investment and fund compliance with governing documents. This will include, as necessary, ERB and/or Consultant's attendance at annual partnership meetings and participation on limited partner advisory boards.
2. Respond to Fund amendment vote requests and key man and other fund events in the best interests of ERB.

3. Monitor and administer the fund commitments on a timely basis and coordinate the receipt of distributions from the investments.

4. Maintain complete and accurate records of all transactions related to each investment and maintain a portfolio accounting and financial control system designed to:
    a. Protect assets, detect errors and insure the reliability of information generated by funds.
    b. Provide timely and accurate performance reporting and asset allocation information.

E. **Reporting Requirements-** The PE Consultant and Staff shall provide the IC with quarterly reports on the PE portfolio, which provide the following:

1. List of fund investments, diversification summary, internal rate of return and the current status of the portfolio versus peer groups and benchmarks.

2. Annual reviews of compliance/variance with the long-term policy and stated goals and objectives for the preceding 12 months and annual goals and objectives for the next 12 months.

F. **Advisory Board Seats -** ERB may consider obtaining a limited partner advisory board seat. This will be considered on a case-by-case basis. The goal of taking a seat on an advisory board is to enhance the ability to oversee the investment and ensure that the fund performs in a manner consistent with ERB investment goals.

IX. Governance and Philosophy

ERB will adopt a philosophy of active engagement with the General Partner community on issues of fund governance, appropriate fees, transparency, industry standard terms and best practices. These activities may include:

A. Work constructively with targeted top tier General Partners to establish investor friendly fund governance and management fee practices that benefit investors like ERB.
B. Participate in Limited Partner focused industry groups in order to stay abreast of industry developments and participate in the ongoing dialog on industry standards and best practices.
C. Establish and maintain ERB’s reputation as a desirable investor in private equity through active engagement on issues of fund governance and industry best practices.

X. Roles and Responsibilities

The roles and responsibilities with respect to the PE Portfolio are summarized below.

A. Investment Committee Roles and Responsibilities:

1. Select the PE Consultant.

2. Approve the PE Policy, as prepared and recommended by Staff and Consultant, and refer to full ERB for its approval.

3. Approve PE investments and monitor the performance of the PE portfolio.

B. ERB Roles and Responsibilities:

1. Approve the PE Policy, as drafted and recommended by Staff and Consultant and recommended by the IC.

C. ERB Staff Roles and Responsibilities:

1. Draft the PE Policy with the assistance of the Consultant.

2. In conjunction with the Consultant, review and approve the investment evaluations and/or plans developed by the Consultant with respect to each PE Portfolio investment.

3. Review, approve and provide a recommendation for each PE Portfolio investment for consistency with the appropriate policy and for general reasonableness.

4. In conjunction with the Consultant, review and approve each PE Portfolio investment redemption or liquidation for consistency with the appropriate policy and for general reasonableness.

5. Meet with the Consultant every three years to update and, if necessary, make revision recommendations regarding the Policy Statements.

6. In conjunction with the Consultant, monitor the PE Portfolio performance.

7. Represent the ERB with respect to all matters related to PE Portfolio investments.

D. **PE Consultant Roles and Responsibilities:**

1. Assist Staff in drafting the PE Policy and review Policy Statements at least every three years and recommend revisions when appropriate.

2. Perform appropriate diligence and prepare recommendations concerning each investment opportunity.

3. Prior to presentations to the IC, provide a review of key terms included in the agreements and/or memoranda associated with the prospective investment.

4. Prepare recommendations, if requested by Staff, concerning each investment redemption or liquidation for consistency with the Policy Statements and for general reasonableness. Meet with Staff at least annually to update and, if

necessary, make revision recommendations to ERB. The Consultant's recommendation shall disclose all placement agents or third party marketing agents related to each investment.

5. Assist the Staff, as its fiduciary, in the monitoring and management of the PE Portfolio.

6. Assist the Staff, to the extent requested, in representing the ERB with respect to all matters related to the PE Portfolio.

7. Present to the Staff, as requested, reasonably qualified investment managers for review, including all relevant due diligence information.

8. Provide investment performance reports consistent with industry standards for quarterly review of investment guidelines and benchmarks.

9. Participate in the Staff established due diligence process including on-site meetings at the General Partner's home office.

10. In connection with the PE quarterly performance report, notify the Staff of situations involving the PE Portfolio's actual investments deviating from the investment guidelines established in the Policy Statements.